Wealth Management

INVESTMENT, TAX AND LIFESTYLE PERSPECTIVES FROM RBC WEALTH MANAGEMENT SERVICES

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2018 year-end tax planning

Opportunities to reduce your 2018 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 this article.

Tax loss selling

If you have realized capital gains during the year, and you are holding securities with unrealized losses, consider selling those securities to realize the losses. This strategy of selling securities at a loss to offset capital gains realized during the year is a year-end tax planning technique commonly known as tax loss selling. Review your 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 needs, 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 a two-day settlement period, in order to utilize the tax loss selling strategy for the 2018 tax year, transactions must be initiated by December 27, 2018 for both Canadian and U.S. securities in order to settle during 2018. Canadian and U.S. option transactions have a one-day settlement, therefore, option transactions must be initiated by December 28, 2018 to ensure a 2018 settlement. Check with your advisor for mutual fund settlement dates.

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 at a loss and both of the following occur:

i) During the period that begins 30 days before and ends 30 days after the settlement date of the disposition, you or a person affiliated with you (i.e., your spouse, a company controlled by you and/or your spouse, or a trust in which you and/or your spouse are a majority interest beneficiary) acquires the identical property that was sold at a loss.

and

ii) At the end of that period (i.e., on the 30th day after the settlement date of the disposition), you or a person affiliated with you owns or has a right to acquire the identical property.

You need to look at your holdings across all accounts when determining if the superficial loss rules apply. For example, if you purchase mutual funds on a pre-authorized

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contribution plan, be sure to check all of your accounts to make sure you are not buying the same mutual fund you are selling (in a different account perhaps) for tax loss purposes within the 60 days that may trigger a superficial loss.

Carry forward and carry back of capital losses

A capital loss must first be applied against any capital gains (including capital gain distributions from mutual funds) you realize in the current year. 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 2015, 2016, or 2017) or carried forward indefinitely to offset future years' capital gains. When you carry back a net capital loss 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 back your losses to 2015 and offset them against your 2015 capital gains.

If you plan on triggering a capital loss in a corporation, you should speak to your qualified tax advisor as it may be advantageous to pay out a capital dividend if your capital dividend account is positive, prior to triggering the loss.

Capital gains deferral

As we approach the end of 2018, if you currently have unrealized capital gains you may want to consider deferring the realization of capital gains until 2019 for the following reasons:

a) Your marginal tax rate may be lower in 2019 than in 2018;

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, 2019. Realizing capital gains at the beginning of 2019 means that any tax payable would not have to be paid until April 30, 2020 (unless you are required to make tax instalments); and,

c) If you have net capital losses in 2018, you can carry back those losses against previously realized capital gains in 2015, 2016 and/or 2017. 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 2018 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 must first be considered, before looking at the tax benefit.

Year-end bonus planning

Receiving a bonus prior to year-end creates additional Registered Retirement Savings Plan (RRSP) contribution room for 2019 if you have not yet reached the maximum 2019 RRSP limit. Furthermore, receiving a bonus prior to year-end may also allow greater employee/employer pension contributions and/or employee profit sharing plan contributions for 2019, if these contributions are based on the prior year's total compensation.

On the other hand, if you expect to be in a lower tax bracket next year, consider deferring the receipt of your bonus (if your employer permits) to early 2019.

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 may not have to be withheld if the bonus or a portion of the bonus is transferred directly to your RRSP. You must have adequate unused RRSP deduction room in the year of transfer.

Low-income year

If you expect to be in a low marginal tax bracket for 2018 and expect to be in a much higher marginal tax bracket in retirement, you may want to consider making an early withdrawal from your RRSP before year-end. The advantage of this strategy is that you can avoid a higher tax rate on these RRSP funds if withdrawn in the future when your marginal tax rate may be higher. If you can reinvest the RRSP funds withdrawn in your non-registered account, you can take advantage of the preferred income tax treatment on capital gains, Canadian dividends and return of capital. Furthermore, if you can reinvest the RRSP funds withdrawn in your Tax-Free Savings Account (TFSA), you do not pay any future tax on the income earned or capital gains realized. The drawback of this strategy is a prepayment of income tax and lost tax deferral on the growth of the RRSP funds withdrawn.

Tax instalments

If you are required to make quarterly tax instalment payments to the CRA, you should make your final payment on or before December 15, 2018 to avoid late interest charges. If you missed an earlier instalment payment deadline, you may want to consider making a larger final instalment payment or make your final instalment payment earlier than the December 15, 2018 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 careful when paying less than the amount indicated 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 that is indicated on the CRA tax instalment reminder statements.

Charitable donations

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 2018 income tax return is December 31, 2018.

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.

If you plan on donating securities in-kind, the transfer must take place before year-end, so ensure you start this process well in advance to allow for processing and settlement time, typically at least five business days. Also, be sure to verify that the charity organization is willing to accept such in-kind donations.

TFSA contributions

If you have not yet done so, you can make your TFSA contribution for 2018 (up to $5,500) and catch up on any unused contribution room from 2009-2017. The TFSA enables you to earn tax-free investment income, including interest, dividends, and capital gains, which may result in greater growth compared to a regular taxable account. You can make tax-free withdrawals at any time, for any reason, and any amount you withdraw is added back to your available contribution room on January 1st of the following year.

If you have not yet done so, you can make your TFSA contribution for 2018 (up to $5,500) and catch up on any unused contribution room from 2009-2017.

If you have contribution room, contributing to your RRSP early (i.e., before December 31, 2018) helps to maximize the tax-deferred growth in your plan which may increase your savings for retirement.

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, 2019 rather than having to wait until 2020 to recontribute.

RRSP contributions

You have until March 1, 2019 to make a contribution to your RRSP or a spousal RRSP in order to be able to deduct the amount on your 2018 tax return. However, if you have contribution room, contributing to your RRSP early (i.e., before December 31, 2018) helps to maximize the tax-deferred growth in your plan which may increase your savings for retirement.

RRSP contributions if you are turning 71

An RRSP must mature by December 31st of the year in which you turn 71. On maturity, you must withdraw the funds, transfer them to a RRIF, or use them to purchase an annuity. You will not be able to make any further contributions to your own RRSP after this date.

If you are turning age 71 in 2018, have earned income for the year, and plan to convert your RRSP to a RRIF, consider making your 2018 RRSP contribution before your RRSP is converted. You will have to make this contribution by December 31, 2018 because the new contribution room based on your 2018 earned income will not be created until January 1, 2019, at which point, your RRSP will have already been converted to a RRIF.

This early contribution (sometimes called the forgotten RRSP contribution) will allow you to claim an RRSP deduction on your income tax return for 2019 or any year thereafter.

If you have already made the maximum contribution for the current year, the CRA will consider your early contribution to be an excess contribution that is subject to the over-contribution tax of 1% of the excess amount per month. On January 1, 2019, your new contribution room, based on your previous year's earned income, will absorb your over-contribution.

For example, if your RRSP contribution limit for 2019 will be $26,500 in December of 2018, you may want to contribute that amount to your RRSP in advance. You will have a one-time tax of approximately $245 (1% of $26,500 - $2,000), taking into account your allowable lifetime over-contribution limit of $2,000. However, your tax deduction for your RRSP contribution on your 2019 tax return combined with the benefit of tax-deferral and compounding growth in the RRIF should outweigh the penalty.

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.

RESP contributions

A Registered Education Savings Plan (RESP) is a way to save for a child's or grandchild's post-secondary education and can also be used as an income splitting vehicle. The lifetime contribution limit is $50,000 per beneficiary and there is no annual contribution limit.

By making RESP contributions, you may be 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. Each beneficiary can receive

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a lifetime maximum CESG of $7,200. Consider contributing to the RESP by December 31st if you haven't maximized your contributions to take advantage of tax-deferred growth in the RESP.

The income earned on the CESG and the contributions within the RESP can be taxed in your child's or grandchild's hands, who likely has a lower marginal tax rate than you, when paid out to them.

Capital gains realized in a trust

If a trust is properly structured, capital gains realized by the trust may be allocated to a minor beneficiary and taxed in their hands with little or no taxes payable. Individuals, including minor children, with no other taxable income can realize approximately $22,000 of capital gains tax-free each year due to their basic personal exemption. The amount varies by your province or territory of residence.

Timing of mutual fund purchases

When you purchase a mutual fund part way through the year, you purchase the fund at its net asset value, which includes any accumulated income and gains that have not yet been distributed. When the fund makes a distribution, the distribution includes these accumulated earnings and the distribution is fully taxable, even though you purchased the accumulated earnings with your after-tax dollars.

There are ways to avoid the distribution. For new purchases, you could simply purchase the fund after the distribution date. This way, you purchase the fund without any accumulated income and gains.

If you have already purchased the fund, consider selling the fund prior to the distribution date. Before selling, you should first consider the size of the potential distribution and the resulting tax liability. It is important for you to determine how much you will save by avoiding the receipt of this distribution in comparison to the costs that a sale could trigger (i.e., redemption fees).

Tax shelters

You may consider purchasing a tax shelter such as limited partnership units or flow-through shares before year-end in order to receive 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 so that you may deduct them against any of your taxable income.

As with any investment, the investment potential of the tax shelter and not just the initial tax savings should be considered when deciding whether to invest in a tax shelter.

Moving within Canada

The marginal tax rates may vary significantly by province or territory. For example, combined with the federal rate, the top marginal tax rate in Nunavut is 44.5% and the top combined rate in Nova Scotia is 54.0%. Since you are generally subject to tax based on your province or territory of residence on December 31st, if you are moving to a province or territory with a lower tax rate, consider moving prior to year-end. If you are moving to a province or territory with a higher tax rate, consider delaying your move until early 2019.

Interest on family loans

If you set up a spousal loan or funded a family trust with a prescribed rate loan, remember to pay the interest owing by January 30, 2019. The borrower may be able to claim a deduction for the interest paid on their tax return. The lender will have an income inclusion on their tax return. The timing of the income deduction and inclusion depends on the year the interest relates to, when the interest is paid, and the method (cash versus accrual) you regularly follow in computing your income.

Year-end expenses

Generally, you can deduct certain expenses you paid in the year on your personal income tax return. Therefore, remember to pay all investment management fees, tuition fees, deductible accounting and legal fees, childcare expenses, alimony, medical expenses and any business expenses (if deductible on your personal tax return) by December 31st if it is your intention to deduct them on your 2018 tax return.

Re-filing your tax waiver

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 the 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.

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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 2019 tax year, you should start applying in late October or early November of 2018.

Tax planning for business owners

If you own a business, you may want to consider the following strategies.

Consider an Individual Pension Plan

If your business is incorporated, 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 defined benefit registered 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 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 slip. 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 IPP.

Pay salaries before year-end

If you operate your own business, consider paying reasonable salaries to yourself and family members who work in the business, before year-end. This year-end payment constitutes earned income which increases RRSP contribution room for the following

If your business is incorporated and the corporation loaned you money, ensure that the loan is repaid before the end of the corporation's tax year after the year the loan was granted to avoid having to include the value of the loan as income on your personal tax return.

year. The payment will also give your business a tax deduction in the current year. The salary paid must be reasonable based on the services performed by your family member. A good rule of thumb is to pay your family member what you would pay someone who isn't related to you.

Declare bonuses before year-end

If your business is incorporated and you require income from your corporation, consider declaring a bonus before the end of your corporation's tax year and pay the amount no later than 180 days after the corporation's year-end. Assuming your corporation's year-end is December 31st, if your corporation declares a bonus on December 31st, 2018, it will get a tax deduction for 2018 and the tax you will have to pay on the bonus will be deferred if you receive it at the beginning of 2019.

Shareholder loans

If your business is incorporated and the corporation loaned you money, ensure that the loan is repaid before the end of the corporation's tax year after the year the loan was granted to avoid having to include the value of the loan as income on your personal tax return.

Purchase assets for your business

If you intend on purchasing assets for your business (i.e., a computer, furniture, equipment, etc.), consider making this purchase before year-end. If the asset is available for use, this year-end purchase will allow your 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.

Conclusion

This article covers some common individual tax planning strategies that you may want to consider before year-end. Speak with your qualified tax advisor to determine if any of these strategies are suitable for you in your circumstances.

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