2016 Year-End Tax Planning Tips for Investors and Holders of Retirement Plans

2017 is quickly approaching, however, there is still an opportunity for investors and persons saving for retirement to review their financial situation with their TD Wealth advisor and explore year-end tax planning. Here are some of the year-end tax planning ideas you may want to explore.

Important Facts and Figures:

Tax-Free Savings Account (TFSA) dollar limit for 2016: **$5,500**

Registered Retirement Savings Plan (RRSP) dollar limit for 2016: **$25,370**

1. Investors

☐ **Review the asset allocation in your portfolio**

Examine the type of income you earned in your non-registered portfolio in 2016. If you earned interest income, which is highly taxed (*i.e.*, unlike dividends or capital gains which are more favourably taxed), consider restructuring your non-registered portfolio for better tax efficiency in 2016 and subsequent years. Also, as per the 2016 Federal Budget, if you exchange, or otherwise dispose of, shares of one corporate-class fund for shares of another after December 31, 2016 you will be considered to have disposed of those shares at fair market value. This means, as of January 1, 2017 you will no longer be able to benefit from tax-deferred switching within the same corporate class structure.

☐ **Review your debt**

Is the interest cost you pay on your debt deductible? If not, and you have other non-registered investments, consider selling some or all of these investments (but first calculate the tax cost of selling the investments) and using the money from the sale to reduce your debt. Then re-borrow the money to replace your non-registered investments. This strategy may provide you with an interest expense deduction in 2016 (and future years) since the interest cost on your new debt may be deductible.

☐ **Observe investment selling deadline for 2016**

If you want to sell stocks and realize accrued capital gains or losses in 2016, the settlement date (not the trade date) on the sale needs to occur in 2016. To ensure this happens, you'll have to initiate the sale on or before Friday, December 23, 2016 (for Canadian securities markets).

☐ **Time your purchase of certain investments**

If you plan on investing in an interest-earning security (like a GIC) with a maturity period of one year or longer, you may want to wait until 2017 before purchasing this investment. If you wait until 2017, you won't have to pay tax on any accrued interest on this investment until 2018 – the year of the first anniversary of your purchase. You may also want to wait until early 2017 to purchase any mutual funds that may make taxable distributions before the end of 2016, in order to avoid paying the tax any earlier than necessary.

☐ Time withdrawals from your TFSA

If you plan on withdrawing funds from your TFSA, consider withdrawing funds in 2016 instead of in early 2017. Withdrawals from your TFSA in 2016 will be added to your TFSA contribution room in 2017; however, if you were to withdraw the same funds in early 2017, the amount would not be added to your TFSA contribution room until 2018.

☐ Realize accrued capital losses before year end

If you realized capital gains in 2016, or in any of the three previous years (2015, 2014 or 2013), you could consider selling your investments which have decreased in value (have an accrued loss) in order to use these capital losses against your capital gains. There is an ordering rule that says capital losses have to first be used to offset capital gains in the current year. Therefore, only the excess capital losses may be carried back to the three previous years. Carrying back capital losses may enable you to get a refund of previously paid income tax that can be used for investments or to pay living expenses. Capital losses can also be carried forward indefinitely. Be aware of the superficial loss rules, as losses may be denied if the same investment/property is purchased 30 days before or after the sale and still hold it on the 31st day after the disposition.

☐ Realize capital gains if appropriate

It may make sense for you to trigger a capital gain before the end of 2016 if realizing that capital gain doesn't result in tax. For example, this might apply if you have capital losses that can be used to shelter the capital gain from tax, or if the capital gain will be taxed in the hands of another person who has little or no other income (*e.g.*, an in-trust investment account for your child(ren)). In such cases, triggering the capital gain by selling an appreciated security and reinvesting the sale proceeds allows you (or your child(ren)) to have a new increased adjusted cost base in the investment without triggering a significant tax liability. This may save you (or your child(ren)) tax on a future sale of this investment. It may be worthwhile to note that there is no superficial gain rule, so gains are recognized for tax purposes.

☐ Defer realizing capital gains if appropriate

If you want to sell stocks at a profit and the sale will give rise to a tax liability, you may want to consider delaying the sale until after December 23, 2016 in order to defer the taxes payable until April 30, 2018.

In this case, for gains realized in 2017, the taxes owing are not payable until April 30, 2018, *i.e.*, the due date for filing your 2017 personal income tax return. For example, if you place a sell order for securities on December 29, 2016, this trade should not settle until January 4, 2017 and therefore would be reportable by you when filing your 2017 personal income tax return.

☐ Claim a capital gains reserve

If you're considering selling capital property before December 31st for a profit, consider negotiating the sale so you can collect the sale price over a period of time greater than one year. Under certain circumstances, you may be able to report the capital gain (and pay the tax) over a period as long as five years (including the year of sale), if you receive payment over this five year period. At a minimum, you should consider receiving part payment in 2016, and part payment in January 2017, in order to spread the tax liability at least over two years (2016 and 2017). You should consult with your professional tax advisor to properly structure the receipt of your sale proceeds in order to claim a capital gains reserve.

☐ Take foreign exchange gains and losses into account

When selling foreign assets, it is important to take into consideration the effect of the foreign exchange at the time of purchase and at the time of sale. Since the Canadian dollar has increased in value relative to other foreign currencies in 2016, the foreign currency translation may impact any capital gains/losses realized.

☐ Donate public securities with accrued gains to charity

Making a charitable donation by December 31st may provide you with a donation receipt that can be used to reduce your tax payable or possibly increase your tax refund for 2016. If you're considering selling any publicly traded securities, you may want to consider donating these securities instead to a charity. Any capital gain realized on your donated public securities is not subject to tax and yet you are still entitled to a donation receipt for the full fair market value of your donated securities. Therefore, donating with public securities having an accrued gain makes better income tax sense than either donating with cash or selling the securities and then donating with the sale proceeds.

2. Retirement Plans

☐ Contribute to your RRSP

You have until Wednesday, March 1, 2017 to make a contribution to your RRSP that would enable you to claim a deduction on your 2016 personal income tax return. You may also make a non-deductible excess contribution to your RRSP to get more money working for you in your tax- deferred RRSP. If you keep your cumulative over-contributions at $2,000 or less (at any time), the 1% penalty tax on over-contributions won't apply.

☐ Reduce your unused RRSP contribution room

If you have been contributing less than the RRSP contribution limit available to you, you will have unused RRSP contribution room. If you have enough cash flow, you could consider making extra contributions to your RRSP to use your unused RRSP contribution room in 2016, resulting in more money being saved for your retirement.

If your taxable income is in a low tax bracket and your taxable income is expected to increase to a higher tax bracket in the future, consider delaying the RRSP contribution deduction to a future year when your taxable income is in a higher tax bracket.

☐ Borrow to contribute to your RRSP

Borrowing money to make an RRSP contribution may be beneficial if the investment return in your RRSP is greater than the interest being charged on the RRSP loan. While the interest expense incurred on a RRSP loan is not deductible for income tax purposes, you can reduce your interest expense on the RRSP loan if you use your tax refund to pay down your RRSP loan balance.

☐ Split income by contributing to a spousal RRSP

If you contribute to a spousal RRSP before December 31st, you can reduce the length of time that should pass before your spouse or common-law partner (Partner) can withdraw money from this spousal RRSP without the attribution rules applying to tax (some or all) the Partner's withdrawal in your hands.

For example, if you contribute by December 31, 2016, your Partner could withdraw those dollars on January 1, 2019 (at the earliest) without his/her withdrawal being reportable and taxable in your hands (attributed back to you). This also assumes you don't make additional contributions to a spousal RRSP in the years 2017, 2018 and 2019. However, if you were to wait until January 1, 2017 to contribute to a spousal RRSP, your Partner will have to wait until January 1, 2020 (*i.e.*, a full year longer) before taking a withdrawal from a spousal RRSP without attributing this withdrawal to you. Again, this assumes that you don't make contributions to a spousal RRSP in the years 2018, 2019 and 2020.

☐ 71 years of age this year? Make an advance contribution to your RRSP

If you are 71 years of age at the end of 2016, December 31 is the last day you can contribute to your RRSP and the deadline for winding up your RRSP. You may want to make your RRSP contribution before this deadline in order to benefit from the tax-deferred growth of your money inside your RRSP sooner. However, if you also have earned income in 2016 which can provide you with RRSP contribution room in 2017 (**<u>or</u>** have unused RRSP contribution room), you might consider making your 2017 contribution (or using up your unused RRSP contribution room) before December 31 when your RRSP matures. While you may incur a small over-contribution penalty for the month of December 2016, you should be entitled to a deduction in 2017 for your RRSP contribution (made in December 2016). This RRSP deduction may save you more tax dollars in 2017, and can ensure that you maximize contributions to your RRSP before it is wound up. You should speak with your professional tax advisors to ensure this strategy is appropriate and your planned over-contribution isn't excessive in your circumstances.

☐ Make RRSP withdrawals in a low-income year

In some cases, it may make sense for you to withdraw money from your RRSP before you retire. For example, if you have little or no other income in 2016, you may be able to withdraw money from your RRSP before December 31st, and pay little or no income tax on your withdrawal. You might also consider this strategy if you require some money to meet living costs or are prepared to re-invest the withdrawn money outside your RRSP.

☐ Maximize your 2016 earned income

Earned income creates RRSP contribution room for you. Accordingly, you might consider increasing your earned income in 2016 to generate the maximum RRSP contribution room for 2017. This could be a consideration if you own your business and control the type and amount of your annual compensation. The RRSP dollar limit for 2017 is $26,010 and can be reached with earned income of $144,500 in 2016.

☐ Convert part of your RRSP to a registered retirement income fund (RRIF) before year-end

If you are 65 to 71 years of age and do not receive pension income, consider setting up a RRIF to provide you with at least $2,000 of annual income because you can receive a pension income tax credit on the first $2,000 of eligible pension income. Furthermore, if you're in the lowest marginal tax bracket, you can receive this $2,000 of income tax-free from your RRIF - thanks to the pension income tax credit. Additionally, if you have a Partner that has little or no other income, consider taking more out of your RRIF and utilizing the joint election to split eligible pension income. If your Partner is also 65 to 71 years of age, he/she can claim the pension income tax credit too.

☐ Buy an annuity to take advantage of the pension income tax credit

As described above, if you are 65 years of age or older, you are entitled to a pension income tax credit on the first $2,000 of eligible pension income. Since annuity payments also qualify for the pension income tax credit, you could buy an annuity (with some of your RRSP money) to provide you with $2,000 of annual income. Again, you can use the pension income tax credit to offset the tax on the annuity income, and if you're in the lowest marginal tax bracket ($45,282 or lower federally for 2016), you would pay no federal income tax on this annuity income. However, if you are in a higher marginal tax bracket, you could have some income tax to pay on this annuity income.

☐ Base RRIF withdrawals on the age of the younger Partner

If you are age 71 in 2016, you have to wind down your RRSP by December 31st. Accordingly, you may likely be transferring most if not all of your RRSPs to one or more RRIFs before year-end. If you have a younger Partner, you may want to consider having your mandatory (*i.e.*, minimum) RRIF income withdrawal based upon the age of your Partner. This decision could reduce your required annual RRIF minimum income, and allow you to defer tax on your RRIF for a longer period of time.

☐ Delay and properly time Home Buyer's Plan (HBP) withdrawals

Under the HBP, you are able to withdraw money from your RRSP and use that money towards the purchase of a home. However, the home has to be purchased prior to October 1 of the year following the year you withdraw the money. Accordingly, given that this is now late in 2016, you may want to consider waiting until early in 2017 before making a HBP withdrawal from your RRSP. This strategy may assist you by extending: i) the time by which you have to buy a home (*i.e.*, prior to October 2018 instead of prior to October 2017 if you withdraw before money before December 31st) and ii) the time until you have to start making repayments under the HBP. In addition, although multiple RRSP withdrawals are allowed under the HBP, generally you have to make all of your HBP withdrawals in one calendar year. Therefore, you may want to consider waiting until 2017 before making any RRSP withdrawal(s) under the HBP.

☐ **Make your required HBP repayment**

If you withdrew money from your RRSP under the HBP in 2014, you have your first repayment due in the 2016 tax year (*i.e.*, before the end of the 2nd year following the year of your HBP withdrawal). This repayment can be made as late as March 1, 2017 (*i.e.*, your 2016 RRSP contribution deadline). You should not forget to make a contribution to your RRSP for 2016, otherwise you may face income tax on any deficient repayment amount. Schedule 7 " *RRSP and PRPP Unused Contributions, Transfers, and HBP or LLP Activities*" of your 2016 personal income tax return is used to designate the amount of your repayment to your RRSP under the HBP.

Revised 09/21/2016