Strength in Numbers

Kemp Harvey Group

Summer 2012 Newsletter

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Deposits matter: TFSA

Canadians are becoming slightly over-zealous with contributions to their Tax-Free Savings Accounts (TFSAs).

This spring, the Canada Revenue Agency (CRA) sent out letters warning many TFSA account owners about over-contributions and the risk of incurring monthly 1% penalties on excess funds in the accounts.

Introduced by the Canadian government in 2009, TFSAs are an alternative to traditional savings accounts. Contributions are not entitled to any initial tax deduction, but all interest income earned within the account is non-taxable. Since inception, the TFSA contribution limit has increased by $5,000 each calendar year. In order to qualify for a TFSA, you must be a Canadian resident and over the age of 18.

Many Canadians are unsure about the parameters of TFSAs. Becoming familiar with some of the guidelines surrounding TFSAs will help you, the taxpayer, avoid penalties stemming from misuse. First of all, it is necessary to be aware of your current TFSA contribution balance. When you file your personal

income tax return each year, the CRA will mail you a Notice of Assessment. This document will state the amount of your tax refund or tax balance owing. In addition, the annual summary will note the contribution limit available on your TFSA account. You must not contribute more than this amount in the current year. Withdrawals do not change your contribution room in the current, or any, year.

When preparing to make a deposit into your TFSA account(s), it is very important to remember that banks and investment advisors cannot always keep track of your total TFSA contributions or limits.

Therefore, a bank or investment advisor may encourage you to contribute to a TFSA, when, in fact, you may have already reached your contribution limit for the year at another financial institution.

Unfortunately, even the CRA does not keep accurate track of the amounts which have been contributed to your TFSA during the calendar year. The CRA will only keep track of contributions made in prior years. It is up to you to keep track of your current-year contributions, in order to ensure your deposits do not exceed the limits set by the CRA.

Your contribution limit for the year is the *total* that you can deposit to your TFSAs. If your contribution limit for 2012 is $7,000: you cannot deposit $7,000, withdraw $3,000, then redeposit $3,000 into the account. You will be assessed a penalty because the total you have contributed is actually $10,000. Deposits count, withdrawals do not.

If you realize you have over-contributed to your TFSA, you can make a withdrawal from your account in order to attempt to avoid any additional penalties.

WEALTH TAX APPEARING GLOBALLY

The Government of Ontario recently introduced a tax bracket for the wealthiest residents of that province. Starting July 1, 2012, for incomes over $500,000, the top tax rate will go up from 46.41% to 49.53%. It is estimated that this will affect ¼ of 1% of all people in Ontario. Previously, the highest tax bracket in Canada was in Nova Scotia, starting at $150,000. Currently in British Columbia, the top tax rate is 43.70% on income over $132,406.

It is important to remember that when your income passes over this threshold, only the income which is above the threshold will be taxed at this higher rate. For instance, in the province of British Columbia, if you have an income of $150,000, your highest income (the amount between $132,406 and $150,000) would be taxed at the highest tax bracket of 43.70 %.

Soon, France will introduce a 75% tax rate.

However, the total tax bill you would pay would only be $45,915, a total blended income tax rate of 30.61%.

It will be interesting to see if a tax on the wealthiest residents will be introduced in British Columbia.

The recently-elected government of France has stated it intends to introduce a 75% marginal tax rate for incomes over 1 million Euros next year. Once in place, this will be the highest income tax bracket in the world.

CREDIT TO BE CUT

In this spring's federal budget, there were very few income tax changes introduced.

One new announcement was the gradual elimination of the Overseas Employment Tax Credit.

With this credit, employees who work lengthy terms in specific industries overseas can qualify to have a portion of their personal taxes eliminated. Individuals can apply for the tax credit on up to $80,000 of their annual overseas income.

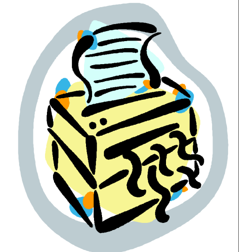
The credit will be eliminated over a period of four years, and will be completely eliminated by 2016.

WHEN CAN I SHRED MY TAX PAPERS?

Many people are confused about the minimum requirements set by the Canada Revenue Agency (CRA) regarding retention of records.

An individual must retain the information which was used to prepare their personal income tax return for six years from the end of the tax year in question. For example, if you claimed a donation or medical slip from February 2006, you must retain this slip until the end of December 2012. Therefore, keeping the documents for seven years covers the requirement.

If you ever reported any business or rental income on your personal tax return, you must also retain certain documentation for even longer than this time frame. If you own an asset, such as a vehicle, which you are currently depreciating over a period of years, you must keep the slip related to the vehicle purchase for six years from the end of the tax year in which you received any deduction at all from the purchase.



DID YOU KNOW...

The highest income tax rate in British Columbia is widely understood to be 43.70% for those with income over $132,406. But, personal income taxes do not always end there.

For seniors collecting Old Age Security (OAS), the highest tax rate is actually 49.60% for incomes between $99,253 and $101,488. This is due to the Old Age Security Clawback.

Depending on your personal income tax bracket, the OAS Clawback can add up to an additional 8.9% on your tax bill.

Split the pension both ways

The Canadian pension income splitting option has been available for several years and is a valuable resource for many pensioners in British Columbia.

Pension-splitting allows couples to allocate a portion of pension income from the higher-earning spouse to the lower-earning spouse when they file their personal income tax return. This results in their household income being spread more evenly between them, and, in turn, the household income is usually taxed at a lower rate.

There are several things to keep in mind in order to optimize your pension splitting options. One option is for couples to transfer up to half of the allowable pension income from one spouse to the other. Income which can be split includes the taxable portion of annuity payments from superannuation or pension funds.

In addition, if you are 65 or older, funds withdrawn from your Registered Retirement Income Fund (RRIF) will also qualify for the split. Therefore, if you are planning on taking money out of your RRSP, it may make sense to transfer the money into a RRIF before making the withdrawal, so that it qualifies for pension-splitting.

Even if spouses are receiving earnings in the same tax bracket, it still could make sense to split pension income. If your partner has no income deemed as "pension", he or she is not receiving any of the pension tax credit – a credit worth up to $2,000. By transferring a portion of your pension income to your spouse, he/she will immediately qualify for the additional pension credit. Up to $350 in taxes can be saved through this process, if at least $2,000 of pension income is transferred to your partner.

Household incomes can vary and pension-splitting allows couples to even out the tax burden.

In some instances, it may make sense to transfer income from the lower income spouse to the higher income spouse. If your partner lives in a residential care facility, it may make sense to transfer pension income to you from them, even if they have a lower income.

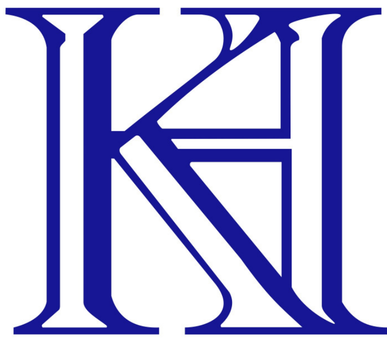
This form of splitting would actually reduce your spouse's residential care fees, because the fees are based on your spouse's annual income. At 80% of your income, residential care fees work out to be significantly higher than the highest personal tax rate of 43.70%. There are some limits to the pension income splitting option. Funds received from the Canada Pension Plan and Old Age Security programs do not qualify as allowable pension-splitting income.

Did you know...

Starting in January of this year, a new "Family Caregiver Amount" tax credit was introduced to taxpayers across the country.

This non-refundable credit of $2,000 can be claimed by those individuals who have an infirm dependant, and it is used to enhance other previously announced credits.

Taxes may be reduced by up to $350 for taxpayers who qualify for this brand-new personal credit.



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CORPORATE TAXES RISING

After years of world-wide economic turmoil, the golden age of Canadian corporate tax reductions may be coming to an end.

Traditionally, the Canadian *small business* corporate tax rate has existed for all corporate taxable income less than $500,000. Any corporate taxable income over $500,000 has been taxed at the *general* corporate tax rate. Provincial and federal rates are blended within these two brackets.

Several years ago, the Government of British Columbia announced it would be reducing the provincial small business corporate tax rate to zero percent, effective April 2012.

Combined with the federal small business corporate tax rate for these same entities, the total tax rate in British Columbia would have been sitting at 11%.

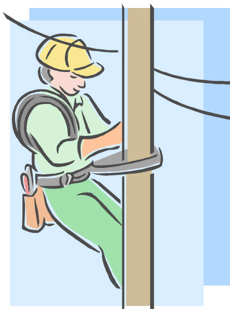
However, this spring, the BC government repealed the drop in the small business corporate tax rate, leaving the provincial rate at the existing 2.5%.

As a result, the total small business corporate tax rate has remained at 13.5%. In addition to the temporary rate freeze, the province announced that, effective April 1, 2014, it will be increasing general corporate tax rate by 1%, bringing it up to 11% provincially.

A similar situation occurred in Ontario, where corporate tax rate reductions were also planned. Their general corporate tax rate was supposed to drop from 11.5% to 10% by 2013, but this was recently repealed.

Federally, this has not been the case. Several years ago, the Canadian government planned for a general corporate tax rate reduction to be implemented in 2012, dropping the federal corporate tax rate for income above $500,000 from 16.5% in 2011 to 15% in 2012. This rate decrease has not been repealed.

CPP RULES FOR SENIOR WORKERS



Prior to 2012, people who had reached the age of 60 were eligible to apply and qualify for Canada Pension Plan (CPP) benefits.

In order to qualify to receive these benefits, these employees must have been off work for two months.

After this qualifying period, they could earn employment income, and have no CPP deducted from their cheque, while receiving CPP benefits. Under the new CPP rules, this two-month waiting period has been eliminated.

However, even though the pensioner may start receiving their CPP benefits, they must still pay premiums on any employment income earned until they are at least 65 years old.

Between the ages of 65 and 70, the pensioner may file a form with the CRA requesting to not have CPP deducted from their paycheques. This document is called the CPT30 form and it is available the Canada Revenue Agency website.