The TaxLetter®

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YEAR-END PLANNING

This season, take advantage of these quick and easy...

Holiday deductions

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The holidays are officially here. And in the spirit of this season of giving, my gift to you is a list of some quick and easy deduction tips to help cut your tax bill.

Claim interest on disappearing investments

Given the state of the market over the past few years, chances are that you may have borrowed money for an investment (or even a business) that may have gone belly-up (or sold for a loss).

And it may be possible that you are being hit with a double whammy: still stuck paying interest on the money you borrowed. However, this interest may still be deductible – but if you have managed to salvage some proceeds and the money is put to personal use rather than re-invested, a portion of your continuing interest charges won't be deductible.

One unhappy exception to these rules is real estate. However, this only applies if the real estate is "directly held." The interest charges should continue to be deductible if, for example, the real estate was held in a partnership or a company.

Another valid case for continuing interest deductions for real estate is if you have managed to salvage some proceeds from the investments, which are in turn then re-invested in the same type of property.

Investment carrying charges

Most investment-related carrying and financial charges are deductible if they were used to earn income, including investment counsel and safety-deposit box charges.

Check your bank statements and look for things like investment or business-related service charges, such as certification or overdraft charges, or charges for new chequebooks.

Also, make sure you've picked up all expenses on your brokerage statements, such as interest on margin accounts or late payments on stock purchases. Although brokerage fees themselves are not immediately deductible, they reduce your capital gains exposure when you sell.

Another possible deduction is interest which becomes payable in 2011 on an investment or business loan – even if you couldn't make the actual payments – if you regularly deduct interest in the year it becomes payable.

Get your GST/HST back

If you're allowed to deduct employment expenses, like your automobile or a home office, you can claim a GST/HST rebate to recover the GST/HST included in the price of goods and services on which you have claimed a deduction.

A similar rebate applies if you earn income from a partnership registered for GST/HST. In both cases, you can recover the GST/HST you pay on expenses that you deduct personally by filing Form GST 370 - Employee and Partner Goods and Services Tax Rebate, with your T1 return.

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Objection expenses

You can also deduct legal fees paid for advice to object to (or appeal) an assessment under the Income Tax Act, the Unemployment Insurance Act, the Canada Pension Plan or the Quebec Pension Plan, plus any related accounting fees (net of any award or reimbursements for such expenses).

Taxable benefits on interest-subsidized loans

If a taxable benefit has been added to your T4 as a result of an interest-subsidized loan from your employer, you may be able to claim an offsetting deduction if the funds were used for income-earning purposes. This could be the case, for example, if you are a member of an employee share-purchase plan.

Tax return preparation fees

If you pay to have your tax return prepared and part of the fee relates to accounting charges for detailing your investment or business income, this portion of the fee should be deductible. Make sure you ask your accountant to send you a separate bill for these charges to back up the deduction.

Foreign tax credits

Claim Foreign Tax Credits if you have received investment income from a foreign source. Because of certain tax rules, your federal foreign tax credit may be restricted. If so, it's possible to claim a foreign tax credit against provincial income taxes by filing Form T2036. If you still can't claim the full credit, the excess foreign tax credit may be deductible.

If you invest in the U.S. through your RRSP, the Canada-U.S. Treaty allows your carrier to apply for a refund of U.S. withholding tax.

Reserves

If you sold an investment for a capital gain, but you're not entitled to receive cash proceeds until after the end of the year, you're allowed to defer a portion of your capital gain by claiming a reserve. Reserves on capital gains may enable you to defer your tax over a five-year period.

Equivalent-to-spouse tax credit

This federal tax credit should be worth approximately $1,579 (equal to the lowest tax rate, 15 per cent for 2011 times the prescribed amount of $10,527 for 2011).

To claim the tax credit: you must maintain and live in your own residence, and have a qualifying dependant who is wholly dependent on you for support during the year.

With the exception of a child, the dependant must be a resident of Canada at some point during the year and wholly dependent on you for support; you must either be unmarried or, if you are still married, you must not live with, or be supported by your spouse.

Qualifying dependants could include a child, grandchild, or sibling younger than 18, someone who is physically or mentally ill, or a parent or grandparent. Note: prior to 2007, this credit was reduced if the dependant's net income exceeded a specified net threshold; however, this has now been repealed.

Have your kids report capital gains

Since you may be footing the bill for school, it only seems right that your kids should foot the bill for capital gains.

If an investment is owned by your kids, the gain can be reported on their tax return. This could dramatically slash – even eliminate – the tax bite. How, you might ask? With the basic personal credits, a child or grandchild with no other income can make over $20,000 a year in capital gains – per child, that is – free of federal tax.

Even if the gain exceeds this amount, your child is in the lowest tax bracket, a rate that is only about half of what a high-income earner would pay. (Note: in most cases, the funding parent must normally pay tax on interest and dividends generated by the investment income until the year the child turns 18 due to the attribution rules; however, if the investment does not generate much income, then this becomes less of an issue.)

Sometimes, people hold an investment for their kids (for example, as a gift for them) but it is registered in the name of the adult. This isn't necessarily a showstopper. For one thing, if the account is registered in your name "in trust," this may show that it is really for your kids.

Another possibility is to visit a tax advisor to discuss documenting the fact that the investment is for your kids e.g. by filling out a legal declaration of trust. ❐