

COMMENT

Number 253 – JANUARY / FEBRUARY 2009

2008 Tax Season

The 2008 tax return filing season will begin shortly and it is important that individuals prepare with great care because, even if they hire professionals, they are still personally responsible for the accurate reporting of all information. Although some taxpayers may not have a current income tax liability, they should still file an income tax return because it provides the basis for the calculation of some benefits such as the Canada Child Tax Benefit, GST/HST credit, provincial and territorial programs, refundable tax credits, etc., which may be of benefit to the taxpayer and can only be accessed by filing an income tax return.

The Canadian tax system is based on voluntary compliance and is the cornerstone of the self-assessing system. This frees up the Canada Revenue Agency (CRA) to conduct systematic and random audits to see how well the system is working. One popular myth that seems to circulate every few years is that the federal government does not have the constitutional right to tax individuals. The federal government's right to tax comes from the Canadian Constitution and this was confirmed by the Supreme Court in 1951.

Taxpayers have for many years been able to file their tax returns electronically. One option is to file directly using NETFILE where the raw information is loaded directly onto the CRA's website. Alternatively, taxpayers can file indirectly by using EFILE where information is assembled into a file and then directly loaded

onto the CRA's website. For the 2007 taxation year, over 13 million Canadians filed using one of these two electronic services. When filing electronically, taxpayers are reminded to keep their receipts because the CRA may request the taxpayer to submit the receipt as part of their review of the taxpayer's file.

Students should not overlook the possibility of important financial gains through the filing of their tax returns. Tax credits are available to students on various amounts, which include qualifying tuition fees, an education amount and a textbook amount, all of which are reported on form T2202A by Canadian educational institutions (and form TL11A/C/D for educational institutions outside of Canada). The education amount can be a substantial benefit, with a credit calculated on an amount of \$400 per month for full-time students and \$120 per month for part-time students who are enrolled in qualifying courses. The textbook amount is similar to the education amount although smaller – \$65 per month for full-time students and \$20 per month for part-time students. Unused amounts can be carried forward or transferred to a supporting parent's or grandparent's tax return.

While a student can deduct eligible moving expenses, these expenses can only be deducted against certain income (i.e., scholarships, bursaries, prizes, grants, etc.) earned after the move. If the moving expenses exceed eligible income earned in the year of the

move, the unused part of those expenses may be deducted from the same type of income received and reported in the following year.

Self-employed taxpayers and their spouses or common law partners have until June 15th to file their tax returns. However, it is important to note that any taxes owing must still be paid by April 30th. This means keeping a close eye on instalments, which are due March 15th, June 15th, September 15th and December 15th of each year.

Individuals selling their homes should report the resulting gain and claim the principal residence exemption in the year of the disposition. While the CRA does not require such disclosure, this reporting confirms the taxpayer's intention to claim the family home as his or her principal residence and is particularly important where there is a second home (such as a cottage) in the family or where only part of the home will qualify for the exemption (if, for example, a substantial portion of the residence was used in a business or rented out).

Restaurant servers, hairdressers, valets, taxi drivers and others who earn tips must bear in mind that tips and gratuities are taxable and must be reported on their tax returns. While cash transactions are very difficult for the CRA to audit, they have various other tools at their disposal. For example, it is a fairly simple matter for CRA to determine such amounts based on clients' credit and debit card transactions. The CRA matches third-party information from employers, spouses and financial institutions, which caught 820,000 taxpayers who tried to under-report income in 2007.

The CRA also has an informant program under which individuals can "tip it off." This program caught over 22,000 taxpayers in 2007. Other programs include the use of industry and regional averages as well net worth audits.

Filing a tax return is not a highlight of the year for most individuals, but it is a necessary evil and allows the system to keep running. Being prepared is key, while staying organized will help anyone deal with the CRA.

I/R 7401.00

New RRIF Rules

On November 27, 2008, the Honourable James M. Flaherty, minister of finance, presented the government's 2008 Economic and Fiscal Statement. Contained in this announcement were changes to the minimum withdrawal rules for RRIFs that would be effective for the 2008 taxation year, but not for subsequent years. In general terms, the intent of the change was to provide seniors with some financial relief in the wake of the tremendous amount of market turmoil of recent times.

The proposed change is to reduce the RRIF minimum withdrawal amount for 2008 by 25 per cent for all annuitants. The RRIF minimum is calculated as the RRIF account balance as at January 1st times the RRIF withdrawal factor based on the age as of January 1st. The following table sets out the RRIF minimum factor and the reduced minimum applicable to 2008:

Age at Jan. 1, 2008	RRIF min. rule	RRIF min. for 2008
65	4.00%	3.00%
66	4.17%	3.13%
67	4.35%	3.26%
68	4.55%	3.41%
69	4.76%	3.57%
70	5.00%	3.75%
71	5.26%	3.95%
72	5.56%	4.17%
73	5.88%	4.41%
74	6.25%	4.69%
75	6.67%	5.00%
76	7.14%	5.36%
77	7.69%	5.77%
78	8.33%	6.25%
79	8.53%	6.40%

Age at Jan. 1, 2008	RRIF min. rule	RRIF min. for 2008
80	8.75%	6.56%
81	8.99%	6.74%
82	9.27%	6.95%
83	9.58%	7.19%
84	9.93%	7.45%
85	10.33%	7.75%
86	10.79%	8.09%
87	11.33%	8.50%
88	11.96%	8.97%

Because this proposal came at year-end after many individuals had already withdrawn 100 per cent of the minimum amount, the proposal also includes a provision for RRIF annuitants to contribute 25 per cent of their RRIF minimum back into an RRSP (if they are less than age 72) or a RRIF if they so choose. This re-contribution can be made until the later of March 1, 2009, and 30 days after the proposed changes have received Royal Assent. The amount of the re-

contribution will be reported on line 232 of the 2008 income tax return.

The Canada Revenue Agency issued a news release dated December 11, 2008, confirming that it would allow taxpayers and financial institutions to implement the proposed 25 per cent reduction of the RRIF minimum for the 2008 taxation year (i.e., that it would administer the new rules as if they were enacted). This means that individuals do not have to wait until Royal Assent and can re-contribute at their convenience.

The change to the RRIF minimum amount recognizes that, in 2008, it could be disastrous to require retirees to withdraw a full minimum amount based on the plan value at January 1st, when the value of their holdings could have fallen dramatically since then. This measure could be very important to some clients as they seek to minimize their 2008 income taxes or preserve their registered savings for future needs.

I/R 5401.07

Tax-Free Savings Accounts

A tax-free savings account – do you have one yet? If not, and if you have any non-registered savings, it is likely that you may be missing a new opportunity that could save you money.

Introduced in the 2008 federal budget and effective for January 1, 2009, the TFSA is an extremely flexible savings vehicle that allows the owner to make contributions (up to an annual maximum amount), to carry forward unused contribution room and to withdraw funds at any time without losing the right to re-contribute an equal amount in a later year. The powerful incentive of the TFSA is that the investment income or growth is not taxed and withdrawals are tax-free. The non-taxability feature means that federal income-tested benefits such as Old Age Security (OAS), the Guaranteed Income Supplement (GIS), the Canada Child Tax Benefit, etc., are not impacted.

- A TFSA can be opened at most financial institutions, including banks, trust companies, credit unions, life insurance

companies, caisses populaires, mutual fund and brokerage firms.

- A TFSA may hold a wide range of qualified investments such as stocks, bonds and other popular portfolios including mutual funds, segregated funds and GICs.
- There is no restriction on how withdrawals can be used. Withdrawals may be made for personal reasons, investment, education or any other purpose.
- The contribution room is calculated as: the contribution room balance at the beginning of the year, plus the annual maximum contribution amount, plus the actual amount of any withdrawals made in the prior year, less contributions made in the current year. In this fashion, unused contribution room is carried forward and new room is created as withdrawals are made (but will not

be available until the year after the withdrawal). It is expected that the CRA will report each taxpayer's contribution room on their Notice of Assessment along with registered retirement savings plan (RRSP) contribution information. Note that contribution room is not dependent on income (or lack of it) in any year.

- An individual must be at least 18 years of age to open a TFSA.
- The maximum contribution amount in 2009 is \$5,000. The maximum amount will be indexed in future years.
- Over-contributions will attract a penalty tax of one per cent per month until the excess is withdrawn.

The reasons for setting up a TFSA are many, ranging from the need for savings to the income tax advantages. The following chart provides a quick summary of the power of the TFSA versus an RRSP or a non-registered plan.

	TFSA	Non-Reg.	RRSP
Cash available annually	2,000	2,000	2,000
Contribution with gross-up	2,000	2,000	3,333
10 years of interest income	6,414	6,414	10,690
Lost to current taxation	zero	2,798	zero
Value at the end of 10 years	26,414	23,616	44,023
Tax if withdrawn	zero	zero	17,609
Net value at year 10	26,414	23,616	26,414

The information in the above chart assumes a combined federal/provincial marginal tax rate of 40 per cent and a five per cent annual rate of interest income, and further assumes that the tax rate will be the same at the time of withdrawal as at the time of contribution. The comparison of a TFSA with an RRSP will differ significantly if there are substantial differences between the tax rates at these two times or if RRSP income would affect eligibility for OAS or GIS payments.

While the TFSA legislation provides tremendous flexibility, each financial institution can design its own approach to the plan provided it meets the legislative requirements. This means that institutions could impose annual administration fees and financial penalties specific to the design of their product. Individuals should clarify in advance how the product meets their particular needs. For example, are there charges, penalties or reduced interest rates associated with withdrawals and plan terminations? While a TFSA allows for tax-free withdrawals, individuals should understand whether the TFSA they are considering has penalties or charges (this is different than income tax) associated with withdrawals or perhaps withdrawals above a minimum number annually. Beyond the legislative design of the TFSA, consumers need to understand the product features that they are purchasing.

Without a doubt, a TFSA will become a common component of every financial plan, whether it is used to accumulate funds in the medium term or to maximize the tax planning opportunity. The TFSA is something every taxpayer should consider.

I/R 7501.00

Subscribe to CLU Comment today at www.advocis.ca.

Contributors to this issue of Comment:

James W. Kraft, CA, MTax, TEP, CFP, CLU, CH.F.C.
Deborah Kraft, MTax, TEP, CFP, CLU, CH.F.C.

Published by:

CLU Institute
390 Queens Quay West, Suite 209,
Toronto, Ontario M5V 3A2
T: 416.444.5251 or 1.800.563.5822
F: 416.444.8031
www.cluinstitute.ca • info@cluinstitute.ca

This commentary is published by CLU Institute in consultation with an editorial board comprised of recognized authorities in the fields of law, life insurance and estate administration.

CLU Institute is the professional organization that administers and promotes the Chartered Life Underwriter of Canada designation.

The articles in CLU Comment are not intended to provide legal, accounting or other advice in individual circumstances. Seek professional assistance before acting upon information included in this publication.

Advocis®, CLU® and APA® are trademarks of The Financial Advisors Association of Canada.

Publication Agreement # 40069004

📄 For news, comment and more, visit the CLU Blog at blog.cluinstitute.ca. 📄