

# Tax Tips for Investors

Knowing how tax rules affect your investments is essential to maximizing your after-tax return. In addition, keeping up to date on changes to the tax rules ensures that you take advantage of all the tax savings available to Canadian-resident individuals.

## Reduce Tax With Income Splitting

Under our tax system, the more you earn, the more you pay in income taxes on incremental dollars earned. With this in mind, it makes sense to spread income among family members who are taxed at lower marginal rates in order to lower your family's overall tax burden, subject to the income attribution rules. Some of the more common income-splitting strategies you may want to discuss with your tax advisor include:

- An interest-bearing loan at the prescribed interest rate to family members in a lower tax bracket. This strategy is particularly attractive because rates are currently at historically low levels.
- Pension income splitting between spouses (or common law partners).
- Gifts to adult children or other adult family members (other than a spouse or common-law partner).
- Gifts to a minor child – directly or through a trust structure – to acquire investments that generate only capital gains.

## Make Your Portfolio Tax Efficient

In evaluating investments for your portfolio, you should consider the impact of income taxes, since not all investment income is taxed in the same manner. Despite

the wide range of investments available, there are three basic types of investment income: interest, capital gains and dividends. Interest income is fully taxed at your marginal tax rate whereas you only pay tax on 50 per cent of a capital gain. Canadian dividends also receive special tax treatment through federal and provincial dividend gross-up and tax credit mechanisms.

## Maximize Your Tax Deferred Savings With an RRSP or TFSA

Your RRSP is likely one of the most important elements in your overall retirement strategy. Allowable contributions to your RRSP are tax deductible and the income earned in an RRSP is not taxed until it is withdrawn. This means that your savings will grow faster in an RRSP than they would if held outside an RRSP. Some ideas to optimize your RRSP savings include maximizing your annual contribution limit, contributing securities "in-kind" to your RRSP, deferring the maturity of your RRSP until age 71 and contributing to a Spousal RRSP if you and your spouse/partner will have disproportionate retirement income levels.

The Tax-Free Savings Account (TFSA), introduced in 2009, is a general purpose tax-efficient savings vehicle that allows individuals, 18 years of age or older, to contribute annually (up to \$10,000<sup>1</sup> in 2015) to a registered account, where income earned within the plan and withdrawals are tax-free.

A TFSA is beneficial for many investors and for many different reasons, including saving for short-term purchases, such as an automobile, or saving longer-term for a child's education or retirement. TFSAs can also be an effective income-splitting tool. A higher-income spouse can give funds to the lower income spouse or an adult child so that they can contribute to their own TFSA (subject to their personal TFSA contribution limits), since the attribution rules will not apply to income earned within the spouse's (or adult child's) TFSA.

Because of its flexibility, a TFSA complements other existing registered savings plans for retirement and education. As a result, the TFSA is quickly becoming an important investment vehicle for many Canadians.

### Use an RESP to Save for Children's Education Needs

The increasing cost of post-secondary education is causing many parents to be concerned about funding. The benefits of Canada Education Savings Grants (CESGs), combined with other recent enhancements to Registered Education Savings Plans (RESPs), make RESPs a very attractive vehicle to fund your children's or grandchildren's education. Contributions to an RESP are not tax deductible. However, the income from investments in an RESP is tax sheltered as long as it remains in the plan. Withdrawals to pay education expenses from accumulated income and the CESG will be taxable in the beneficiary's hands at his/her marginal tax rate.

### Use an RDSP to Save for the Financial Needs of a Disabled Child

The Registered Disability Savings Plan (RDSP) is a registered savings plan intended to help parents and others save for the long-term financial security of persons with severe or prolonged disabilities who are eligible for the Disability Tax Credit. Contributions up to a lifetime maximum of \$200,000 per beneficiary can be made to an RDSP until the end of the year in which the disabled

beneficiary turns 59, with no annual limit. Contributions are not tax deductible; however, any investment earnings that accrue within the plan grow on a tax-deferred basis.

In addition, Canada Disability Savings Bonds (CDSB) and Canada Disability Savings Grants (CDSG), up to annual and lifetime limits, can be received in an RDSP from the federal government depending on family income.

### Donate Appreciated Securities

The benefits of making a charitable donation are countless from helping those in need to the personal satisfaction we feel when giving something back to a cause we feel passionate about. With proper planning, you can also reduce your income tax liability and maximize the value of your donation. A donation of publicly-traded securities may be preferred over a cash donation of equal value, particularly in cases where you have already decided to dispose of the securities during the year. A charitable tax receipt equal to the fair market value of securities donated to charity will reduce your taxes through a donation tax credit. On donations over \$200 this can result in a tax savings of approximately 46 per cent of the value of the donation (depending on your province of residence).

A donation of securities is considered a disposition for tax purposes. However, because of the tax incentives, on a donation of qualifying appreciated publicly-traded securities to charity the capital gain inclusion rate is nil instead of the normal 50 per cent that would otherwise apply.

### Use Borrowed Funds to Invest

Generally, interest expenses are deductible for tax purposes if the funds are borrowed for the purpose of earning income from a business or an investment vehicle. Therefore, consider paying down non-deductible personal debts (such as RRSP loans, mortgages on home purchases and credit card balances) before paying down deductible investment-related debt. Speak with your tax advisor about structuring your borrowing to achieve tax deductibility.

## Reduce Tax For Your Estate

Your estate plan can accommodate a number of tax-saving strategies to reduce or defer the amount of tax payable by your estate and maximize the amount available to your heirs. Some of the most common planning strategies include establishing a trust in your Will to split investment income, naming an appropriate beneficiary for your RRSP/RRIF or TFSA, making charitable bequests in your Will, and bequeathing appreciated assets to your spouse (or a qualifying spousal trust) to defer tax on the accrued capital gains.

As a result of measures originating from the 2014 Federal Budget, significant changes are forthcoming in 2016 which will impact estate donations as well as the taxation of testamentary trusts, spousal, alter-ego and joint-partner trusts. For more information, please refer to our comprehensive **2015 Tax Tips for Investors** brochure and be sure to consult with your external tax and legal advisors to determine the possible impact to your existing Wills and estate plan.

## Consider U.S. Estate Tax Implications If You Own U.S. Investments

U.S. estate tax can apply to Canadian residents on the value of U.S. assets owned at death, even if they are not U.S. citizens or Green Card holders. For 2015, a Canadian

may have a U.S. estate tax liability if the value of their U.S. assets exceed US\$60,000 and the value of their worldwide estate assets exceed US\$5,430,000 at their time of death. The U.S. estate tax rates range from 18% to 40%.

Although any potential U.S. estate tax liability may be reduced or offset by credits and deductions available under Canadian and U.S. tax law and the Canada-U.S. Tax Convention (the "Treaty"), a U.S. estate tax return may still need to be filed even if there is no ultimate U.S. estate tax liability. Failure to file a U.S. return can result in a denial of treaty benefits and credits. In addition, an estate, beneficiary or surviving joint owner may not be able to sell U.S. real property without proof that a U.S. estate tax return has been filed and the tax owing, if any, has been paid.

## Take Advantage of Federal Tax Credits

In addition to the other general tax planning strategies discussed, there are a number of federal tax credits available that can help you reduce your income tax liability when you file your 2014 personal tax return. The following chart provides an overview of several common federal tax credits you may be eligible to claim. Each province and territory may have comparable thresholds and rules.



2014 Federal Tax Credits

	Special rules	To whom the credit may be transferred	Carry-forward
Family tax cut (known as "income-splitting")	New for 2014! For families with children under 18; maximum credit is equal to the lesser of \$2,000 and the federal tax reduction that would result if up to \$50,000 of taxable income were transferred from the high-earner spouse to the low-earner spouse	Either spouse may claim	n/a
Tuition	Credit available only if at least \$100 is paid in fees to an institution	Spouse, parent or grandparent (Maximum combined credits transferable is \$750)	Indefinite
Education	Credit = \$60/month for full-time students and certain disabled part-time students; \$18/month for other part-time students		
Textbook	Credit = \$10/month for full-time students and certain disabled part-time students; \$3/month for other part-time students		
Medical	Credit is based on amount by which qualifying medical expenses exceed the lesser of \$2,171 and 3% of net income (generally, expenses for any twelve-month period ending in the year can be claimed)	Either spouse may claim	n/a
CPP/QPP and EI	For employees, maximum credit = \$501 (in Quebec, \$411); self-employed persons deduct 50% of CPP/QPP premiums paid for their own coverage (maximum deduction of \$2,426; in Quebec \$2,536) and claim a credit for the non-deductible half of premiums paid (maximum credit \$364; in Quebec \$318); self-employed persons do not pay EI premiums		
Canada Employment	Credit is based on employment income		
Transit pass	Public transit passes (monthly or longer) and certain weekly and electronic payment cards are eligible	Spouse or parent	5 years
Student loan interest	Interest must be paid on qualifying student loans	n/a	
Charitable donations	Eligible donations are limited to 75% of net income	Either spouse may claim	
Spouse and equivalent to spouse	Reduced by any net income of the spouse or qualifying dependant	n/a	
Infirm dependant	Reduced if dependant's income exceeds \$6,607		
Caregiver	For providers of in-home care for an adult relative (reduced if relative's income exceeds \$15,472)		
Age	Reduced if income exceeds \$34,873	Spouse	
Pension	Credit is not available for CPP, QPP, Old Age Security or Guaranteed Income Supplement Payments		
Child	Credit available for each child under 18; credit will be repealed after 2014		
Adoption	Must be claimed in the year the adoption period ends	Either parent may claim	
Children's fitness	Maximum credit is \$150 for children under 17; \$225 for children under 19 who qualify for the disability tax credit; credit will be refundable after 2014		
Children's arts	Maximum credit is \$75 for children under 17; \$150 for children under 19 who qualify for the disability tax credit		
Disability	Basic	Spouse, parent, grandparent, child, grandchild, sibling, aunt, uncle, niece or nephew	
	Under 18 Supplement		

Source: PwC Tax News Network, Personal tax credits - November 17 2014. Used with permission. © 2014 PricewaterhouseCoopers LLP.

06/15-1453



We're here to help™

BMO Financial Group provides this publication to clients for informational purposes only. The information herein reflects information available at the date hereof. It is based on sources that we believe to be reliable, but is not guaranteed by us, may be incomplete, or may change without notice. It is intended as advice of a general nature and is not to be construed as specific advice to any particular person nor with respect to any specific risk or insurance product. The comments included in this publication are not intended to be a definitive analysis of tax applicability or trust and estates law. The comments contained herein are general in nature and professional advice regarding an individual's particular tax position should be obtained in respect of any person's specific circumstances. You should consult your health care professional regarding your personal circumstances, an independent insurance broker or advisor of your own choice for advice on your insurance needs, and seek independent legal and/or tax advice on your personal circumstances. All rights are reserved. No part of this report may be reproduced in any form, or referred to in any other publication without the express written permission of BMO Financial Group. ® "Nesbitt Burns" is a registered trade-mark of BMO Nesbitt Burns Inc. BMO Nesbitt Burns Inc. and BMO InvestorLine Inc. are wholly owned subsidiaries of Bank of Montreal.

**Members of the Canadian Investor Protection Fund. Members of the Investment Industry Regulatory Organization of Canada.** If you are already a client of BMO Nesbitt Burns, please contact your Investment Advisor for more information.

BMO BMO Private Banking is part of BMO Wealth Management. Banking services are offered through Bank of Montreal. Investment management services are offered through BMO Private Investment Counsel Inc., an indirect subsidiary of Bank of Montreal. Estate, Trust, Planning and Custodial Services are offered through BMO Trust Company, a wholly owned subsidiary of Bank of Montreal.

® "BMO (M-bar roundel symbol)" and "We're here to help." are registered trade-marks of Bank of Montreal, used under licence.