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FALL 2010

A Year-End Tax To-Do List

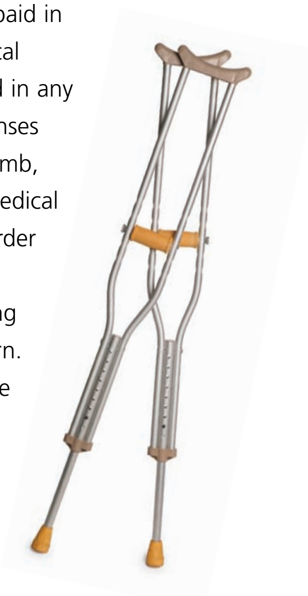
FOR MOST CANADIANS, December means holiday celebrations and school vacations. In the tax world, however, December 31 marks the deadline by which most tax-planning and saving strategies must be put in place in order to have an impact on one's tax liability for the 2010 tax year. What follows is a list of tax "to-do's" that must be accomplished by the end of the calendar year – and one item that can wait until early in 2011.

Things to be dealt with by December 31, 2010

Medical expense credit calculation

When preparing their tax returns, many taxpayers find the computation of medical expenses eligible for the medical expense tax credit somewhat confusing, and that confusion is understandable. First of all, in order to be claimed, medical expenses must total more than 3% of the taxpayer's net income for the year, or a specified threshold amount ($2,024 for 2010), whichever is less. As a rule of thumb for 2010, taxpayers who have a total income of less than $67,466 can claim all qualifying medical expenses in excess of 3% of their net income for the year. For example, a taxpayer earning $45,000 could claim qualifying medical expenses over $1,350 (3% of $45,000). Where the taxpayer's income is over $67,466, only those medical expenses over the $2,024 threshold may be claimed for credit.

To add to the confusion, it is possible to claim medical expenses that were paid in 2009 on the 2010 return. The actual rule is that a taxpayer can claim medical expenses (in excess of the threshold percentage, as outlined above) incurred in any 12-month period ending during the taxation year, assuming that such expenses were not claimed on a previous tax return. Here there is no easy rule of thumb, except that for tax purposes, the best result is obtained where significant medical expenses can be grouped together and paid within a 12-month period in order to maximize the claim rather than spreading them out. So, as December 31 approaches, it is a good idea to add up the medical expenses incurred during 2010, as well as those paid during 2009 and not claimed on the 2009 return. Once those totals are known, it will be easier to determine whether to make a claim for 2010 or to wait and claim 2010 expenses on the 2011 return. If the decision is to make a claim for calendar year 2010, knowing what



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medical expenses were paid and when will enable the taxpayer to determine the optimal 12-month period for the claim. Finally, it is a good idea to look into the timing of medical expenses that will have to be paid early in 2011. It may make sense to accelerate the payment of those expenses to December 2010 where that means that they can be included in 2010 totals and claimed on the 2010 return.

Make charitable donations for 2010

The federal and provincial governments all provide a two-level tax credit for donations made to registered charities during the year. To earn a credit for the tax year, donations must be made by the end of the calendar year. There is, however, another reason to ensure that donations are made by December 31. For federal purposes, the first $200 in donations is eligible for a non-refundable tax credit equal to 15% of the donation. The credit for donations made during the year that exceed the $200 threshold is, however, calculated as 29% of the excess.

As a result of the two-level credit structure, it makes sense to aggregate donations in a single calendar year where possible. A qualifying charitable donation of $400 made in December 2010 will receive a federal credit of $88 ($200 times 15% plus $200 times 29%). If the same amount is donated, but the donation is split equally between December 2010 and January 2011, the total credit claimed is only $60 ($200 times 15% plus $200 times 15%), and the 2011 donation can't be claimed until the 2011 return is filed in April 2012. Of course, the larger the donation in any one calendar year, the greater the proportion of that donation that will receive credit at the 29%, rather than the 15% level.

It is also possible to carry forward, for up to five years, donations that were made in a particular tax year. So if donations made in 2010 do not reach the $200 level, it is usually worth holding off on claiming the donation and carrying forward to the next year in which total donations, including *carryforwards*, are over that threshold. Of course, this also means that donations made but not claimed in any of the 2006, 2007, 2008, or 2009 tax years can be carried forward and added to the total donations made in 2010 and the aggregate amount claimed on the 2010 tax return.

Finally, when claiming charitable donations, it is possible to combine donations made by oneself and one's spouse and claim them on a single return. Generally, and especially in provinces and territories that impose a high income surtax – Ontario, Nova Scotia, Prince Edward Island, and the Yukon – it makes sense for the higher-income spouse to make the claim for the total of charitable contributions made by both spouses.

TFSA withdrawals

2010 is the second year in which taxpayers can make contributions to a Tax-Free Savings Account (TFSA), and every taxpayer is subject to a $5,000 annual limit for contributions. One of the benefits of TFSAs is that, where amounts are withdrawn from a plan, the withdrawn amount is added to the taxpayer's TFSA contribution limit for the following year. So, for example, a taxpayer who contributes $5,000 to a TFSA during 2010 but withdraws $2,000 of that contribution during the year will have a $7,000 TFSA contribution limit for 2011 (made up of the usual $5,000 limit for 2011 plus the $2,000 withdrawn the previous year). Consequently,

taxpayers who currently have funds in a TFSA but are planning to make a withdrawal in early 2011 – perhaps to pay for a winter vacation – should think about making that withdrawal before the end of 2010, so as to preserve the option of replacing the funds in the plan during 2011. If the same taxpayer waits until January 2011 to make the withdrawal, he or she wouldn't be eligible to replace the funds until 2012.

Spousal RRSP contributions

Under Canadian tax rules, a taxpayer can make a contribution to a Registered Retirement Savings Plan in his or her spouse's name and claim the deduction for the contribution on his or her own return. When the funds are withdrawn by the spouse, the amounts are taxed as the spouse's income, at a presumably lower tax rate. However, the benefit of having withdrawals from a spousal RRSP taxed in the hands of the spouse is available only where any withdrawal takes place no sooner than the end of the second calendar year following the year the contribution is made. Therefore, where a contribution to a spousal RRSP is made in December 2010, the spouse can withdraw that amount as of January 1, 2013 and have it taxed in his or her hands. If the contribution isn't made until January or February of 2011, the contributor can still claim a deduction for it on the 2010 tax return, but the amount won't be eligible to be taxed in the spouse's hands on withdrawal until January 2014. This is an especially important consideration for couples approaching retirement, who may plan on withdrawing funds in the relatively near future.

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Recent News

Frequent Flyer points

IN A RECENT TAX COURT of Canada case, frequent flyer points were allowed to be claimed as the travel portion of qualifying medical expenses. It was said that the points represented a monetary value and that by redeeming them the taxpayer had effectively paid for the flight. While this certainly sets precedence, it remains to be seen if frequent flyer points will be allowed as further deductions when in other situations.

Allowable moving expenses

THE INCOME TAX ACT allows for certain deductions when claiming moving expenses. One of the conditions to qualify is that the move must be from one home where you "ordinarily resided" prior to the move, to another home where you "ordinarily resided" after the move. In a recent court case, the term "ordinarily resided" was questioned. The Judge ruled that when moving from a permanent home to a small rental apartment temporarily while looking for a suitable permanent home, only the second move, to the permanent residence, will qualify as eligible moving expenses.

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Take a look at tax instalment amounts

Millions of Canadian taxpayers (particularly self-employed and retired Canadians) pay income taxes by quarterly instalments, with the amount of those instalments representing an estimate of the taxpayer's total tax liability for the year.

The final quarterly instalment will be due on December 15, 2010. By that date, almost everyone will have a reasonably good idea of what his or her income will be for 2010 and, therefore, will be in a position to estimate what the tax bill will be for the year. While the tax return forms to be used for the 2010 tax year haven't yet been released by the Canada Revenue Agency, it is possible to arrive at an estimate by using the 2009 form. Increases in tax credit amounts and tax brackets from 2009 to 2010 mean that using the 2009 form will result, if anything, in a slight overestimate of tax liability for 2010.

Once one's tax bill for 2010 has been estimated, it is possible to compare that figure with the total of tax instalments already made in 2010 and determine whether the tax instalment to be paid on December 15 can be adjusted downward.

Things that can wait (for a bit)

RRSP contribution deadline

Most taxpayers are aware that the deadline for making an RRSP contribution to be claimed on the 2010 tax return falls at the end of February 2011. More precisely, the deadline is 60 days after the end of the calendar year, which, in 2011, will be March 1.

Where the March 1 deadline happens to fall on a weekend, the federal government has typically made an administrative concession by allowing contributions to be made on the next business day. However, in 2011, March 1 is a Tuesday, so taxpayers should not anticipate receiving any kind of extension with respect to the deadline. To be eligible for deduction on the 2010 return, RRSP contributions will have to be made by midnight on Monday, March 1, 2011.

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