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TAXATION

Year-End Tax Issues

Check your portfolio; you may not have to pay as much capital gains tax as you thought.

As the year end approaches owner-managers can find themselves faced with difficult choices in order to keep the tax liabilities of their businesses, themselves and their families to a minimum. Three important areas are capital losses, pre-tax remuneration vs. dividends and RRSP contributions.

Capital Losses

If you have an investment portfolio outside your TFSA, RRSP or RRIF, you should review it with your investment advisor to see whether you could reduce your capital gains by taking some capital losses before the end of the year. Since capital losses can be carried forward from prior years to offset gains in the current year, review your last tax return with your Chartered Accountant to see whether any capital losses are available. Keep in mind that any sales to create capital losses must be made at least three trading days before the final settlement date of December 31 in any given year.

For 2011, because of the way the holidays fall, the last day to sell a stock may be December 23. Check with your broker to make sure. Further, if you sell the losing stock to get the benefit of the capital loss but would like to repurchase it to retain a position in the company, you must wait 30 days or you will not be able to claim the capital loss (the superficial loss rule). The capital loss would also be denied if your spouse were to acquire the stock either from you or on the market within that 30-day period and continue to hold it at the end of that period.

Next Year's Capital Losses

Investors who realize capital gains (net of capital losses) in 2011 but have no losses carried forward will pay tax on the capital gains. However, because capital losses can be carried back three years, capital losses generated in 2012, 2013 and 2014 can be used to recover taxes paid on the capital gains incurred in 2011. Just in case you are thinking of selling a security at a loss in order to create a usable capital loss then repurchasing under your RRSP umbrella, remember the superficial loss rule will still apply.

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Paying out taxable profits can reduce the corporate tax rate to zero.

Pre-Tax Remuneration vs. Dividends

Salaries and bonuses to owner-managers or family-member employees should be considered as a way of reducing corporate taxes. Your Chartered Accountant can determine how additional remuneration to family members will impact the collective tax liability of the family. Your Chartered Accountant may also be able to time the payment of remuneration to reduce the corporate taxes paid while deferring the personal income tax liability to the following year.

Payment of cash dividends is another option. Cash dividends are paid out of retained earnings, i.e., after the corporate income tax has been paid, and attract a lower income tax rate than remuneration, which is deducted in computing corporate income and therefore before the calculation of the corporate tax liability.

The choice between cash dividends or remuneration can become contentious where tax rates vary among family members and where not all family members are shareholders. Taking dividends rather than salary, for example, will impact CPP and future RRSP contributions. Thus, it is advisable to be aware of the impact on each family member and to obtain shareholder consensus on the preferred means of remuneration.

Although dividends may be declared any time in the year, they are not taxable until they are actually paid. Any plan to defer payment to a later calendar year should be discussed with your Chartered Accountant as it impacts the corporation as well as the individuals receiving the dividends.

RRSP Contributions

Owner-managers who decide to give themselves or family members a raise to reduce corporate taxes, may put themselves in a higher income tax bracket. Then, the only means of reducing personal taxable income may be to contribute to an RRSP. For 2011, the RRSP limit is $22,450.

Keep in mind that, if you have not yet made the maximum contribution (the lesser of $22,450 or 18% of 2010 earned income minus any pension adjustment) for the 2011 calendar year, you have until March 1, 2012, to do so. The cash realized from a dividend or salary deferral from 2011 received in 2012 can therefore be used to top up your 2011 contribution.

The On-Time Payment Rules for Taxes

There is some confusion as to what constitutes paying on time. Some payments are considered to have been made only when received by the CRA; other payments are considered to have been made when mailed.

For clarification, section 248(7) of the *Income Tax Act* reads:

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For the purposes of this Act,
(a) anything (other than a remittance or payment described in paragraph 248 (7) (b)) sent by first class mail or its equivalent shall be deemed to have been received by the person to whom it was sent on the day it was mailed; and
(b) the remittance or payment of an amount
(i) deducted or withheld, or
(ii) payable by a corporation,
as required by this Act or a regulation shall be deemed to have been made on the day on which it is received by the Receiver General.

Payments at Financial Institutions

Payments for HST, income or withholding taxes made at any financial institution belonging to the Canadian Payments Association will be accepted on the day they are processed. A payment made at an Automated Teller Machine (ATM) must be processed the same day to be considered paid on the payment date. Payments will be late if they are made after public banking hours since many financial institutions do not process the data until the following day. Payments made Friday after closing are usually not processed until the following Monday.

If, however, the due date falls on a Saturday, Sunday or public holiday, the payment will be considered "on-time" if the funds are processed by the financial institution or received by CRA on the next business day. For example, if the deadline is Saturday, April 30, and the return is mailed on April 30 but not received by CRA until Monday, May 2, it is considered to have been received on time. If, however, a payment required by Tuesday, April 30, is mailed on April 30 and not received until Wednesday, May 1, it is considered late.

Seek Advice from Your CA

Addressing capital-gains-and-loss issues, salaries, pre-tax remuneration or dividends, and RRSP contributions with your Chartered Accountant before year end should be foremost on the minds of owner-managers at this time of year. Some ways of reducing tax liability may be time sensitive and require a review of available options with shareholders and family members.