TAXTALK

2021 YEAR END TAX PLANNING

As the end of 2021 fast approaches, this TaxTalk is a reminder to evaluate your finances and contemplate ways to improve your tax position. Personal tax planning is important to the management of your financial affairs and should be considered throughout the year – not just late in the year.

The aim of tax planning is straightforward: to minimize your tax burden or to defer taxes to a later tax year. Tax planning can also prevent certain events that create unwelcome tax consequences.

This TaxTalk will assist individuals to take advantage of planning opportunities available before the end of this year to ensure you are dealing with these changes in a tax effective manner.

Below, we have included a checklist to help you make sure you are making the most of your potential tax savings opportunities for 2021. The checklist is broken down into sections that look at some key deadlines, your investments, your retirement and estate planning, and some employee planning matters. Keep these in mind to save taxes in 2021.

A. IMPORTANT DATES AND DEADLINES

Many deductions and credits are available only if payments are made by December 31, 2021 or early in 2022.

Important dates are summarized below:

December 29, 2021

- Final trading day for Canadian exchanges for those wishing to have trades settled in 2021.

December 31, 2021

Last opportunity to make a payment for the following items in order to utilize any applicable credit or deduction on your 2021 return:

- Investment counsel fees.
- Carrying charges on investments.
- Interest expenses.
- Professional membership and union dues.
- Charitable donations.
- Political contributions.
- Medical expenses.
- Moving expenses.
- Alimony and support payments.
- Child care expenses.
- Certain legal, tax and accounting fees.
- Tuition fees and interest on student loans.
- Payments to employer to reduce standby charge.
- Contributions to Registered Education Savings Plans to qualify for 2021 Canada Education Savings Grant.
- Contributions to Registered Retirement Savings Plans (RRSP) for those reaching 71 years of age in 2021.

January 30, 2022

- Interest owing on loans from family members (including loans to trusts) so that the income attribution rules will not apply for 2021 and subsequent years.
- Interest owing by an employee to his or her employer, in order to reduce the interest benefit on a low-interest or interest-free loan for 2021.

February 14, 2022

- An employee can reduce or avoid an operating cost benefit related to an employer provided automobile, if he or she reimburses the employer for personal-use operating costs.

February 28, 2022

- Last day to file T4, T4A, T5 Summary and Supplemental forms.

March 1, 2022

- Deductible contributions to an individual's RRSP or a spousal RRSP (for 2021).
- Repayments of RRSP Home Buyers Plan and Lifelong Learning Plan (for 2021).

March 15, 2022

- First quarterly personal income tax instalment due for 2022.
- Employer Health Tax Annual Return (EHT).
- Employer Health Tax allocation agreement to be filed by associated companies.

May 02, 2022

- Balance outstanding on 2021 personal taxes payable.
- Personal T1 return to be filed (however, returns for *self-employed persons* are due on June 15, 2022, but any tax owing is still due May 02, 2022).

B. HIGHLIGHTS OF PERSONAL TAX IN 2021

There have been no changes to the federal and Ontario personal tax rates. The following table summarizes the marginal tax rates (on regular income, i.e., salary, interest, etc.) that apply to the income tax brackets for 2021:

Taxable Income *(See Note)*	**Combined Federal and Ontario Rate (%)**
$ 13,808 to $ 45,142	20.05
$ 45,143 to $ 49,020	24.15
$ 49,021 to $ 79,505	29.65
$ 79,506 to $ 90,287	31.48
$ 90,288 to $ 93,655	33.89
$ 93,656 to $ 98,040	37.91
$ 98,041 to $150,000	43.41
$150,001 to $151,978	44.97
$151,979 to $216,511	48.29
$216,512 to $220,000	51.97
Over $220,000	53.53

Note: These are the federal and Ontario tax brackets.

C. OWNER-MANAGER COMPENSATION

With the introduction of the income splitting and passive income rules a few years ago, it is important to re-evaluate how money is being taken out of the corporation by an owner-manager. While some of the traditional income splitting planning has been eliminated, there are still opportunities available.

Due to the complex nature of the new rules, feel free to reach out to us to discuss what options may be available to you.

We are also happy to sit down with you and review your overall structure to identify any compensation, estate or income splitting planning that can be undertaken to reduce your tax bill.

D. INVESTMENTS

Investments Held in Corporations

If you earned passive investment income through a private corporation that operates an active business, you may be adversely affected by the passive investment income rules.

Under these rules, the small business deduction is reduced on a straight-line basis for affected companies with between $50,000 and $150,000 of investment income, so that the small business deduction is completely eliminated for corporations earning passive investment income of $150,000 or more.

Since these rules apply to associated corporations and certain related corporations, isolating passive investments in a separate corporation may not prevent a reduction to another company's small business deduction.

Also, under these rules, a private company will need to pay non-eligible dividends to obtain dividend refunds on certain taxes that could previously been refunded when an eligible dividend was paid.

Since these rules are already in effect, planning should be considered prior to the year end to reduce the impact of these rules on corporate income and dividend payments.

Tax Free Savings Account (TFSA) Contributions

Canadian residents age 18 and over are eligible to open a TFSA. Income (interest, dividends, capital gains etc.) earned in a TFSA is ***not taxable*** as it is earned, nor is it taxable when withdrawn from the account.

Contributions to a TFSA are ***not tax deductible***. For 2021, the maximum contribution is $6,000 plus any outstanding contribution room carried forward. If no contribution has been made to a TFSA, the 2021 contribution limit will be $75,500. You are able to contact CRA by phone or online to confirm your contribution room. Contribution limits are not affected by income (although annual tax returns must be filed with CRA in order to generate contribution room) and any unused TFSA contribution room may be carried forward indefinitely.

You can withdraw funds at any time and for any purpose without incurring any tax liability. The funds withdrawn will not affect your eligibility for income tested benefits such as Old Age Supplement, Canada Child Tax Benefit or Guaranteed Income Supplement. If you need to withdraw funds from your TFSA, consider withdrawing funds in 2021 rather than deferring to early 2022 because withdrawals from a TFSA are not added back to your TFSA contribution limit until the beginning of the year following the year you made the withdrawal.

It should be noted that the attribution rules do not apply to funds you gift to your spouse to invest in a TFSA, which makes the TFSA ideal to split income with a lower-earning spouse, common-law partner or adult child.

Interest on money borrowed and fees incurred to invest in the TFSA are not tax-deductible. Capital losses realized within the TFSA can be applied to capital gains within the TFSA but cannot be applied against capital gains realized outside the TFSA. Unlike an RRSP, the TFSA may be used as loan collateral.

Crystalizing Capital Losses

When you are deciding which investments to sell, you should consider the following tax planning points:

- Sell investments with accrued losses before the end of 2021 to offset your taxable capital gains realized in 2021 or any of the three preceding years.

If you realize a capital loss in 2021, there are special rules that will deny your loss to the extent you, or a person who is affiliated with you, purchases the same investment within 30 days before or after the sale. The denied loss is added to the cost of the investment acquired by you or the affiliated person, and reduces the gain or increases the loss on a subsequent disposition of the investment. This rule effectively defers the recognition of the loss until the investment is sold to a non-affiliated person.

E. RETIREMENT AND ESTATE PLANNING

Maximizing RRSP Contributions

Three factors limit the amount you can contribute to an RRSP.

- A dollar limit ($27,830 for 2021 and $29,210 for 2022);
- 18% of your 2020 (i.e. the previous year) earned income; and
- Your pension adjustment (which represents the value of pension contributions made by you and your employer in the year).

CRA includes a “2021 RRSP Deduction Limit Statement” as part of the 2020 Notice of Assessment. This statement indicates the maximum amount deductible on the 2021 tax return and any RRSP contributions made in prior years that you have not claimed a tax deduction for. You should verify these amounts prior to making any RRSP contributions.

Please feel free to contact us if you require assistance in confirming your RRSP contribution limit.

Spousal RRSP Contributions

You can contribute all or part of your RRSP deduction limit to a “spousal” RRSP in which your spouse[1] is the annuitant. Your ability to contribute to a spousal RRSP is limited by your own RRSP deduction limit, not by your spouse’s RRSP deduction limit or RRSP contributions. Advantages of a spousal RRSP include income splitting and, where your spouse is younger than you, a longer tax-deferral period for income earned in the RRSP.

Generally, RRSP withdrawals from a spousal RRSP are taxed in the hands of the recipient spouse. However, if your spouse withdraws funds from a spousal plan in the same calendar year as your contribution or in the two subsequent calendar years following your contribution to a spousal plan, the withdrawal will be taxed in your hands.

Finally, if you can no longer contribute to your own RRSP based on age, you can still contribute to a spousal RRSP for which you will receive a deduction, provided you have a deduction limit and your spouse is 71 or younger at the end of the year.

[1] *“Spouse” includes a spouse by marriage or a common-law partner.*

Timing of RRSP Contributions

RRSP contributions you make by March 1, 2022 may be deducted on your 2021 tax return, subject to your 2021 RRSP deduction limit. Any unused RRSP contributions can be carried forward indefinitely to age 71 and deducted when you have additional RRSP deduction limit, however, undeducted RRSP contributions in excess of $2,000 may be subject to a penalty. If you expect a spike in your 2022 income it, may be more beneficial to carry the RRSP contributions to 2022 instead of claiming on your 2021 tax return.

The maximum age for holding an RRSP is 71. If you turn 71 in 2021, your RRSP contribution for 2021 should be made before you convert your RRSP to a RRIF which is no later than December 31, 2021. However, as a result of 2021 earned income, you will generate additional RRSP contribution room on January 1, 2022 but you will not be able to contribute in 2022 if you turned 71 in 2021.

Old Age Security (OAS) Claw back

If your net income in 2021 is over $79,845 then you will have to repay 15% of the excess over this amount, to a maximum of the total amount of OAS received. The OAS claw back is calculated solely on your net income and is not affected by your spouse's income.

Individual Pension Plan (IPP)

An Individual Pension Plan (IPP) is an employer-sponsored defined benefit pension plan to provide enhanced retirement benefits and important tax advantages. An IPP offers several key benefits, including:

- Making a one time lump sum contribution for past years of employment;
- May provide higher contributions than permitted by RRSPs;
- IPP investments grow on a tax-deferred basis;
- IPP contributions are tax-deductible to your corporation as a plan sponsor;
- Employer contributions are not considered a taxable benefit for the employee;
- Fees to set up and administer the IPP are tax deductible by the employer;
- Potential tax deferral via transfer to younger generation.

An IPP could be ideal if you:

- Are an incorporated self-employed business owner or professional;
- Between the ages of 40 and 71 with annual T4 income greater than $100,000; and
- An employer looking to enhance retirement benefits for a key employee.

Personal Pension Plan (PPP)

The Personal Pension Plan (PPP) is similar to the IPP and offers many of the same benefits.

A PPP differs from an IPP since it allows a plan member to switch between a defined benefit plan, a defined contribution plan and an additional voluntary contribution sub account. A PPP also allows for a Corporate Trustee which can shield the individual trustees from taking on legal liability and potential risks of non-compliance.

The fees associated with a PPP may be higher than an IPP due to the additional flexibility that allows the plan members to switch between a defined benefit plan and a defined contribution plan and also provides additional fiduciary oversight.

F. EMPLOYEES

1. Employee Benefits

Taxable Benefits for Employer-Provided Vehicles

Where your employer provides an automobile for personal or employment use, you will be taxed on the following:

a) The **standby charge** is a notional benefit based on the cost of the automobile, or lease payments, for providing the automobile to you, the employee.

   The standby charge is 2% per month[2] (whole or partial) of the original cost of the vehicle. Where your employer leases an automobile for employee use, the standby charge is 2/3 of the lease payments.

   The standby charge is reduced if two conditions are met: (i) your total personal use of the automobile, in a calendar year, is less than 20,000 kilometres, **and** (ii) your personal use is less than 50% of total use.

[2] *For employees principally employed in selling or leasing automobiles, the stand-by charge is decreased.*

The fact that an automobile depreciates in value does not reduce the standby charge. As a result, if the fair market value of a used vehicle is substantially less than its original cost, it may be prudent for you to purchase the vehicle from your employer[3]. Subsequent to your purchase, your employer could reimburse you for the employment use of the vehicle as discussed below.

b) The **operating cost benefit** relates to your personal use of your employer's automobile.

If your annual employment-related use exceeds 50% of total use, the operating cost benefit can be calculated as one-half of the standby charge, less reimbursements made by you to your employer. You must notify your employer in writing by December 31, 2021 if you wish to have the operating cost benefit calculated as one-half of the stand-by charge.

If your employment-related use is less than 50%, or you choose not to have the operating cost benefit calculated as one-half of the standby charge, the operating cost benefit is calculated at 27 cents per kilometre of personal use.

You can reduce or eliminate the operating cost benefit if you reimburse your employer for personal-use operating costs. The reimbursement must be made by February 14, 2022.

You should review your personal use of your employer-provided automobile before December 31st to determine how close you are to the 50% threshold. It may help to reduce personal use between now and year end to reduce the stand-by charge or operating cost benefits.

In addition to your taxable benefits, an employer-provided automobile creates a HST liability for your employer. The HST liability is 13/113 of the standby charge plus 9% of the operating-cost benefit. Your employer is required to compute and self-assess HST on the benefits.

Employee-Owned Vehicles

As indicated above, an allowance received by you for an employee-owned or leased vehicle can be received tax-free if the allowance is computed based solely on employment related kilometres and not more than 59¢ for the first 5,000 kilometres and 53¢ for any additional kilometres.

In addition to paying the prescribed rates, you should keep a logbook for the employment related kilometres. Each entry in the logbook should include the starting point, the destination, the total kilometres travelled, and the purpose of the travel. Also note that kilometres travelled between your home and your office is not considered business travel.

An allowance received for employment-related use of your (owned or leased) automobile, which is not based on a per kilometre rate, is not considered reasonable and must be included in your income. If an allowance is included in your income, then you may deduct the portion of your automobile expenses that relates to employment use[4] to reduce or eliminate the impact of the income inclusion.

Employee Loans

The taxable benefit that arises in 2021 from a low-interest loan by your employer to you is reduced by interest paid by you to the company by January 31, 2022. You can claim an interest deduction to offset the taxable benefit for the imputed interest benefits, to the extent you used the funds to earn income from a business or property.

2. Employee Deductions

Employment Expenses

Certain expenses incurred by you to earn employment income are deductible against that employment income. It is important to retain receipts and document the expenses in your records, noting date, purpose and HST paid in order to substantiate the deductions. Employees are not entitled to claim capital cost allowance (CCA - depreciation for tax purposes), with the exception of CCA with respect to an automobile, airplane or musical instrument used to perform their employment duties. More types of expenses are eligible for deduction if you earn commission income from your employment.

If you are a non-commission employee, you are restricted to deducting employment-related items, such as travel costs, automobile expenses, supplies, office rent, and salary paid to an assistant.

If you are a commission employee and certain conditions are met, you are not restricted to the expenses noted above for non-commissioned employees. You are entitled to deduct a greater variety of expenses to the extent they are incurred to earn commission income. Cellular phones, computers and fax machines should be leased in order to obtain tax deductions for the lease expenses since CCA on these capital expenditures is not deductible. For any year, the amount of expenses deductible is limited to the amount of commission income earned.

[3] *Alternatively, the standby charge would be reduced if your employer sells the car and repurchases it at current value.*

[4] *To deduct automobile expenses on your tax return, you must receive a duly-completed form T2200 - Declaration of Conditions of Employment from your employer.*

Office in Home Eligibility (traditional rules)

Under normal circumstances, if you are required by your employer to maintain a home office, you may be able to deduct some expenses related to the office space[5]. For home office expenses to be deductible, you must either:

- perform more than 50% of your employment duties at home; or
- use the area exclusively in respect of earning income from your office or employment and use it on a regular and continuous basis for meeting customers, clients, patients, etc.

To deduct office in home and other employment expenses from income, form *T2200 - Declaration of Conditions of Employment* must be completed and signed by your employer and retained by you with your records.

Office in Home Eligibility (temporary rules)

The Liberal Party platform stated that if they were elected they would extend the temporary home office expenses till 2022. This extension would also include an increase from $400 to $500 for the temporary flat-rate method for employees with modest expenses.

Employees who worked from home more than 50% of the time over a period of at least four consecutive weeks in 2021 will be eligible to claim the home office expenses deduction for 2021. Also, CRA's home office eligibility guidance (see above) indicated that employees need to be principally working from home – meaning more than half the time – for the year.

Flat-Rate Method

The temporary flat-rate method will allow eligible employees to claim a deduction of $2 for each day they worked from home in 2021, up to a maximum of $500.

Under this method, employees will not have to get Form T2200 or Form T2200S completed and signed by their employer. The new method also eliminates the need for employees to determine their expenses to calculate their claim. However, it's important to note that employees who use the temporary flat-rate method can't claim any other employment expenses such as meals and entertainment or motor vehicle expenses.

Detailed Method

Under the detailed method, eligible employees who work from home in 2021, can claim the amount paid for eligible expenses, supported by documents.

For employees choosing to file under this method, the CRA continues to allow the simplified versions of the T220S, Declaration of Conditions of Employment for Working at Home Due to Covid-19 and Form T777S, Statement of Employment Expenses for Working at Home Due to Covid-19.

G. PRESCRIBED RATE LOAN PLANNING

The government's prescribed interest rate is currently 1% and will likely remain at 1% for some time due to the pandemic. However, CRA sets the prescribed rate quarterly.

Families can obtain tax benefits in utilizing a 'prescribed rate loan'. These include using a low-interest loan as an income splitting tool, or refinancing an existing loan arrangement that was initially implemented using a higher interest rate.

To the extent you have kids and they are minors, a 'prescribed rate loan' to a family trust is also an effective income splitting option that can be effective if set up properly.

A 'prescribed rate loan' is created when a high-income family member (the lender) loans investment capital to the borrower, who can be a low-income family member or family trust, at a rate of interest that is at least equal to the CRA prescribed rate in effect at the time of the loan.

Once the loan is established, the interest rate is maintained for the life of the loan even if CRA subsequently increases the prescribed rate.

There are some important details to ensure that a prescribed rate loan is set up properly. A formal loan agreement must be in place in writing specifying the rate of interest and the interest on the loan must be paid no later than 30 days after the end of the calendar year.

[5] *Home office expenses that are deductible for employees include a prorated portion of rent, utilities, repairs, and cleaning materials. CCA, insurance, property taxes, and mortgage interest are* ***not*** *deductible. However, if you earn commission income you may also deduct a prorated amount of insurance and property taxes.*

We Can Help

Your MG advisor can help you review your personal or business tax situation and help you decide which steps you can take before the year end to help you with the taxes you will pay for 2021.

A memorandum of this nature cannot be all-encompassing and is not intended to replace professional advice. Its purpose is to highlight tax planning possibilities and identify areas of possible concern. Anyone wishing to discuss the contents or to make any comments or suggestions about this TaxTalk is invited to contact one of our offices.

Offices:

First Canadian Place
100 King Street West, Suite 5700
Toronto, Ontario M5X 1C7
Phone: 416-362-0515

1900 Minnesota Court, Suite 116
Mississauga, Ontario L5N 3C9
Phone: 905-451-4788
Fax: 905-451-3299

TaxTalk is prepared by our Tax Group (taxtalk@mgca.com). Please visit our web site at www.mgca.com.

McCarney Group LLP is an independent member of Morison Global