CURRENT DEVELOPMENTS

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YEAR END TAX PLANNING

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RRSP contributions must be made by March 1, 2006 to be deductible for 2005

Tax planning is most effectively carried out throughout the year, and the latter part of the year is an appropriate time to review various income tax and financial planning techniques that are available to individual and corporate taxpayers. Most tax planning transactions require analysis before being implemented so that they can be applied properly and in the right circumstances. For this reason, and since certain matters affected by the Federal and various provincial budget proposals could differ from the actual law when enacted, all taxpayers should consult with their financial and tax advisors before initiating any of the strategies outlined in this issue.

Registered Retirement Savings Plan (RRSP)

The 2005 contribution is limited to the lesser of 18% of 2004 earned income or $16,500 ($18,000 for 2006), minus the pension adjustment (PA) which applies to members of registered pension plans or deferred profit sharing plans. Some taxpayers may benefit from a pension adjustment reversal (PAR) in certain circumstances. Your 2004 Federal Notice of Assessment includes information on your 2005 RRSP contribution limit and unused contributions from prior years.

An individual who does not contribute his/her deduction limit for a year can carry forward this unused deduction room indefinitely.

Contributions do not have to be deducted in the year they are made, but can be carried forward and deducted in a future year.

A contribution in excess of the annual limit can be carried forward to be applied against the deduction room for any subsequent year. No penalty applies where an RRSP overcontribution (cumulative) is not more than $2,000, any excess being subject to a 1% per month penalty.

Earned income for RRSP purposes is the total of all salaries (net of employment expenses), alimony, net research grants, income (loss) from a business, rental income (loss) and disability payments received under the Canada and Québec Pension Plans. Support (alimony and maintenance) payments made by the taxpayer will reduce earned income for RRSP purposes, if deductible for tax purposes.

The foreign property rule in respect of deferred income plans (including RRSPs) which limited the amount of foreign property that a plan can hold was eliminated in 2005.

All or part of an RRSP contribution may be made to a spousal plan (without affecting the contribution available to the spouse) if the spouse is under age 70. This can serve as an income splitting method upon the eventual withdrawal of the funds, provided the funds are left in the plan for a sufficient period of time.

RRSP contributions should, where possible, be made early in the year to benefit from the longer period that income is earned on a tax-sheltered basis within the RRSP.

Employees can ask their employer to pay a portion of their salary directly into an RRSP without deduction of income tax at source.

Contributions other than in cash are also permissible to self-administered RRSP plans. However, a non-cash contribution may result in a gain or loss for tax purposes. A capital gain would be taxable while a capital loss would be non-deductible.

A recipient of certain payments, most notably amounts received on leaving employment which are categorized as "retiring allowances", can transfer all or a portion (based on specific limits) to their **own** RRSP on a tax deferred basis.

Individuals who have RRSP deduction room after age 69 will be able to contribute to a spousal RRSP up until the end of the year in which their spouse turns age 69.

If you turn 69 this year, you must mature (wind-up) your plans by December 31, 2005.

In order to avoid paying tax immediately upon the maturity of an RRSP, an annuity can be purchased and/ or the RRSP can be transferred to a RRIF.

If you turn age 69 this year and consequently cannot contribute to an RRSP in 2006 (assuming a spousal plan contribution is not available), you may contribute your 2006 - available RRSP deduction in December 2005 (before winding-up your RRSP) and pay a maximum penalty of $160 (1% of $16,000).

RRSP Education Withdrawals

Eligible individuals are able to make tax free withdrawals from an RRSP to finance full-time training or education for themselves or their spouses. Withdrawals may not exceed $10,000 in a year and will be permitted for a period of up to four calendar years, provided that the total amount withdrawn does not exceed $20,000. Withdrawals under the plan will be repayable by the recipient in equal instalments over a period of 10 years, with the first payment due no later than 60 days after the fifth year following the first withdrawal.

The RRSP Home Buyers' Plan

Subject to certain conditions, an individual who is a first-time home buyer can borrow up to $20,000 in a single year from his or her RRSP, repayable over a 15 year period. If you intend using the Plan towards year-end, consider deferring your withdrawal until after December 31. This will extend by one year the time period for repaying the amounts withdrawn.

Individual Pension Plan (IPP)

An IPP is an option for owners of incorporated businesses who wish to boost the amount of their retirement savings. Contributions are made by reference to the owner's salary and the pension benefit desired, and can significantly exceed RRSP contribution limits, including a potentially large past-service contribution (and deduction) by the corporate employer.

Registered Education Savings Plan (RESP)

Under an RESP, contributions are made to a plan intended to pay for the post-secondary education of designated beneficiaries, usually the taxpayer's children or grandchildren. Although contributions are not tax-deductible, income earned in the plan is not taxable until distributed, at which time it is taxed in the hands of the beneficiary. Annual contributions are limited to $4,000 per beneficiary to a lifetime total of $42,000.

The Federal government will provide a grant (CESG) generally equal to 20% of the first $2,000 of annual contributions made to RESPs for each child up to age 18. A social insurance number must be provided for each child. The CESG will be payable on contributions made in the year to a maximum of $400 per child per year ($500 in certain limited circumstances).

Capital Gains Exemption

The capital gains exemption continues to be available to individuals who have not fully utilized it, but only in relation to gains realized on qualified small business corporation shares (or a family farm property).

Notwithstanding the income attribution rules, it may be advantageous to transfer a certain portion of qualifying growth assets to children to enable future capital gains to be exempt from taxation by utilizing the child's capital gain exemption.

Consideration should be given to crystallizing a gain that qualifies for the exemption. Because of AMT, however, a crystallization may be more beneficial if spread over two years.

Be aware of the possible disadvantage of selling investments eligible for the $500,000 capital gains exemption and investments with losses in the same year. Capital losses realized in the year must be offset against capital gains of that year including "exempt" gains, thus leaving a smaller amount available to claim the exemption against.

Capital Gains and Losses

Capital losses realized in 2005 (net of any capital gains realized) can be carried back up to three years and carried forward indefinitely to offset capital gains reported in other years.

Capital losses will not be recognized at the time of disposition where, during the period that begins 30 days before and ends 30 days after the disposition of the property, the taxpayer or a person affiliated with the taxpayer acquires an identical property (a "superficial loss").

Corporations should consider paying a dividend out of the Capital Dividend Account (essentially the tax-free portion of net capital gains) prior to the realization of capital losses.

We encourage our clients to contact us before implementing any of the strategies described above, as the specific facts in a particular situation may indicate an alternate strategy. And remember that taxation concerns are only one aspect of a complete investment plan - before realizing losses attention should be given primarily to the quality of the investments involved and their place in one's investment plan.

Capital Gains Rollovers for Small Business Investors

To improve access to capital for small businesses with high growth potential, there exists a tax measure which, subject to certain conditions, permits individuals to defer capital gains on eligible small business investments to the extent that the proceeds are reinvested in another eligible small business.

Income Splitting

Investment income earned by an individual who is related to a lender who has made a low or non-interest bearing loan to them, will be attributed to the lender. This will not apply where the loan is to a related person other than a spouse or minor child if it can be shown that none of the "main" reasons for the loan was to reduce or avoid tax.

Since the attribution rules are extremely complex, caution is advised when contemplating a transfer of property or a loan to a spouse or a child (including transfers indirectly through a corporation in which they are shareholders). That being said, some basic planning ideas would include:

-gifting growth assets to a minor child, as the resulting capital gain is not attributed to the donor;

-gifting property to a child who is not a minor;

-segregating and re-investing "attributed" income of a spouse or minor child;

-segregating and investing child assistance and child tax benefit payments;

-using the higher-earner's income to pay all family expenses and segregating and investing the lower-earner's income;

-using a trust for the benefit of family members to hold shares of a closely-held corporation. However, there are restrictions in regard to income-splitting with minor children.

Income splitting may be achieved by having your spouse be your business partner or by having a business owner pay reasonable salaries to his or her spouse or children.

Spouses can choose to share their QPP and CPP retirement pensions.

Personal Income Tax Instalments

Individuals who are required to make quarterly instalments should review the amounts paid, to avoid or reduce the non-deductible interest charged (which can be onerous) on late or deficient instalments. Individuals are required to remit their Federal and Québec instalment payments on or before March 15, June 15, September 15 and December 15.

If the tax liability for 2005 will be less than originally estimated, the December remittance can be reduced accordingly.

Canada Revenue Agency and Revenue Québec will continue to notify individuals required to remit instalments of the amount of each instalment determined on the basis of tax information from prior years. Payments made in accordance with these notifications will always avoid interest charges.

Tax Assisted Investments

When considering tax assisted investments, it should be noted that most are speculative in nature. While they may result in significant tax savings, there remains a cost to the investor.

The decision to invest should be based on the quality of the investments as well as the favourable tax treatment they receive.

Film Investments

The purchase of an ownership interest in certified Canadian films continues as a tax deferral vehicle by allowing the investor certain tax credits.

Investment in the Petroleum and Gas and Resource Industries

These investments, whether made directly, through a partnership or by the purchase of shares, allow the investor a deduction from income of varying amounts depending on whether the investment is in oil and gas or mining.

The income tax rules and financial implications relating to such investments are extremely complex and should be reviewed on an individual basis.

SME Growth Stock Plan

The Québec Stock Savings Plan will not be revived but will be wound down gradually and replaced by the SME Growth Stock Plan. This new plan will end on December 31, 2009. A single deduction rate, 100% of the adjusted cost of eligible shares, will apply. The annual deduction cap of 10% of the individual's income for a year that applied under the former QSSP will apply under the new plan.

Pension Income Credit

An individual may be entitled to a tax credit (Federal and Québec) on up to $1,000 of pension income. OAS and QPP (CPP) pensions are not eligible for the pension income credit. The Québec credit is reduced when "family income" exceeds $28,030.

If there is not sufficient pension income to qualify for the full amount of the credit, additional qualifying income can be created by commencing to receive pension income in the form of a life annuity and, if age 65 or older, also by converting all or part of your RRSP plan into an annuity, or by simply purchasing an ordinary (unregistered) life annuity contract with other funds.

Donations

If planning to make any donations to a public charity, consider contributing marketable securities that have inherent gains, as the income-inclusion rate of the resulting capital gain is one-half of what it would otherwise be if the security were sold. The donation credit is based on the market value of the securities.

Alternative Minimum Tax (AMT)

The AMT imposes a minimum tax on certain individual taxpayers and could adversely affect those high-income individuals who have significant deductions arising from investments in tax shelters. Certain shelters such as flow-through shares of mining companies, etc. as well as large capital gains may subject the individual to the AMT in 2005.

Taxpayers who have paid the AMT in the past may have an opportunity in 2005 (and following years) to recover part or all of the AMT previously paid.

Changes to the Québec AMT system in 2003 will result in individuals (including trusts) being far less likely to be subject to AMT. The changes will also make it easier to recover AMT paid in prior years.

Salary/Dividend Planning

Many aspects must be considered in determining the most beneficial combination of remunerating the owner/manager of a closely-held corporation.

As with other planning, each case must be examined separately and no one "rule of thumb" can apply to all situations.

Some factors to be considered are:

The tax rate of the corporation
The tax rate of the individual
The need for salary income by the individual to qualify for RRSP and CPP/QPP contributions or to benefit from child care expenses
Québec restrictions on the deductibility of investment expenses by individuals.

Some planning techniques include:

Remuneration that is accrued and expensed by a corporation must be paid to the employee within 179 days of the corporation's year-end. Where that year-end falls in the latter half of the calendar year (actually, after July 6), the corporation can cause the owner/manager's remuneration to fall into either the current or subsequent calendar year.

The payment of dividends can be used to reduce or eliminate the owner/manager's CNIL, thus maximizing the amount of capital gains exemption which may be available to the taxpayer.

Timing of Acquisition of Assets

Accelerate the acquisition of depreciable property used in carrying on a business otherwise planned for the beginning of the next year. This will allow additional depreciation to be available to be claimed in the current year. The "available-for-use rules" should be considered (generally requiring the depreciable property to be used in operations for the depreciation deduction to be allowed).

Consider delaying until the subsequent year the acquisition of depreciable property in a class that would otherwise have a terminal loss in the current year.

Shareholder Loans

If contemplating a loan from a corporation to a shareholder, the potential taxability should be evaluated.

TO OBTAIN CURRENT DEDUCTIONS AND TAX CREDITS, THE FOLLOWING EXPENDITURES MUST BE PAID BY DECEMBER 31, 2005

- Investment counsel fees
- Safekeeping fees (not deductible for Quebec purposes)
- Certain legal and accounting fees
- Safety deposit box rentals (not deductible for Quebec purposes)
- Deductible interest expenses, including interest on student loans
- Child care expenses
- Charitable donations
- Political contributions
- Medical expenses in excess of the lesser of 3% of net income or $1,844 (for Federal purposes only; the threshold cap is unlimited for Quebec)
- Professional membership fees and union dues
- Support payments (child support payments are non-deductible for new and revised agreements after April 30, 1997)
- Deductible moving expenses
- Expenses associated with an objection or appeal related to a tax assessment
- Tuition fees

Corporation Tax on Capital

A tax on capital may be imposed on certain large corporations for Federal tax purposes and all corporations in certain provincial jurisdictions. This tax may be reduced for a corporation that has cash on hand by using it before the end of its fiscal year to (a) reimburse shareholder loans, (b) reduce existing borrowing, or (c) acquire eligible investments.

In regard to Québec tax on capital, eligible investments must also meet the following criteria:

Investments in bonds, commercial paper and bankers' acceptances of other corporations have to be held for a continuous period of at least 120 days including the date of the taxation year end;

The 120 day holding period has been extended to cover bonds of partnerships, and **shares** of banks and related corporations;

Shares of and loans to other corporations are generally not restricted.

Employee Stock Options

Employees are able to defer the income inclusion of benefits that result from exercising eligible employee stock options for publicly listed shares until the disposition of the shares, subject to an annual $100,000 limit. Employees disposing of such shares will be eligible to claim the stock option deduction in the year the benefit is included in income.

Gifts and Awards To Employees

The CRA and Revenue Québec have liberalized their approach towards employee gifts and awards.

Employers can now give their employees on a tax-free basis two non-cash gifts and two non-cash awards each year. The total cost of the gifts and the total cost of the awards must not exceed $500. Certain conditions apply.

Other Matters to Consider

Interest Deductibility

Whenever possible, ensure that debt is structured so that the interest expense is deductible. When repaying an existing debt, pay off the debt that has non-deductible interest before debt with deductible interest.

Québec restricts the deductibility of investment expenses including interest and advisor fees. Investment expenses are only deductible by individuals to the extent of investment income, including taxable dividends and taxable capital gains. Disallowed investment expenses can be carried back up to three years or forward indefinitely. The Federal government is also considering certain restrictions.

Contact your BGK advisor to discuss ways to minimize the impact of these measures.

Wills and Mandates

Wills should be reviewed and updated on a periodic basis, taking into consideration changes in family circumstances (e.g., children emigrating), financial position and legislation.

U.S. Citizens in Canada

A U.S. citizen resident in Canada must file Canadian and U.S. income tax returns, reporting world-wide income. These tax returns should usually be prepared by a competent professional advisor due to the complicated interplay of foreign tax credits.

U.S. citizens and residents with Canadian RRSPs or RRIFs are able to elect to defer recognition of the income arising in the plans until it is received. Recent IRS announcements have significantly increased the U.S. reporting requirements for such plans. Individuals affected by these announcements should contact us for more details.

Logbook for an automobile - Québec

For 2005 and onward, an employee who benefits from an automobile made available by his employer will have to supply the employer with a copy of the detailed logbook he or she maintains with respect to the automobile so as to allow the employer to accurately determine the employee's taxable benefits. The copy of the logbook has to be provided within ten days from the end of the year or from the end of the period in which the automobile was made available to the employee. Failure to provide the logbook to the employer will result in a penalty to the employee of $200.

Manpower Training

Québec employers with a payroll in excess of $1,000,000 are required to spend the equivalent of 1% of their payroll on job training.

Employers subject to this 1% requirement that do not expend that amount will be required to contribute the shortfall as a "tax". Consequently, employers should evaluate their manpower training programs and facilities in order to determine how they can meet the criteria that will enable them to reduce or eliminate the tax.

Eligible training expenses incurred in a year in excess of the 1% required can be used in the following year.

Mutual Funds

Many funds make distributions at the end of the year. If you are thinking of purchasing fund units at this time, you may be receiving an unexpected income inclusion without the benefit of the growth in value of the units through the year.

Foreign Withholding Taxes

Foreign withholding taxes are only creditable at the rate allowed for in the particular treaty. Ensure that, for example, withholding taxes on U.S. dividend income do not exceed 15%.

Any excess may have to be recovered from the source country.

Government Pensions

For persons who have turned or are about to turn 65, assure that OASP and QPP/CPP retirement applications are prepared.

Reduced QPP/CPP retirement benefits are available to persons between age 60 to 65 **and** retired.

Enhanced QPP/CPP benefits are available if the application is delayed until after age 65 (up to 70).

Old age spousal or widow(er)'s allowances may be available, based on an income test, to a person aged 60 to 64:

- whose spouse is a GIS (OASP Supplement) recipient, or
- who is a widow(er)

Québec Prescription Drug Insurance Plan

When Québec residents turn 65 they are automatically enrolled in the Québec Prescription Drug Insurance Plan and are subject to the $507.50 annual maximum premium. If you are in this situation and are also a member of a group insurance plan that fully covers prescriptions, you may request to the Régie de l'assurance maladie du Québec that you not be covered by the Québec plan. If you opt out of the Québec plan, ensure that you use the group plan **only**, and for **every** prescription purchased during the year. However, the associated costs and benefits must be evaluated before opting out.

All individuals under 65 who are eligible for coverage under a group insurance plan (e.g. members of many professional bodies) **must** purchase coverage under the group plan for themselves (and their spouse and children) and are ineligible for the Québec plan.

The matters described herein, as well as other techniques used in tax planning, should be subject to ongoing review and analysis and, frequently, some decisions may more appropriately be implemented earlier, rather than later, in the year.

Snowbirds

Canadians who spend on average more than 120 days a year in the United States run the risk of being considered a U.S. resident for U.S. tax purposes. If you are caught under the specific rules, but have spent less than 183 days in the U.S. in the current year, the "Closer Connection Exemption" may apply. The exemption is claimed by filing IRS form 8840 on a timely basis (generally June 15 of the following year). Please contact your BGK advisor for more details.

Ontario Health Premium

The Ontario Health Premium is fully phased in for 2005 with premiums ranging from $0 where an individual's taxable income is less than $20,000 to $900 where taxable income exceeds $200,600.

Did You Know.....?

This and other issues of *Current Developments* are available on our web-site - http://www.bgk.ca

DATES TO REMEMBER

December 15, 2005	Fourth personal income tax instalments for 2005 are due.
December 15, 2005	Deadline for filing the annual Québec Registration Declaration for corporations.
December 23, 2005	Final day of trading on Canadian stock exchanges so that the transaction will be recognized in 2005 for the calculation of capital gains and losses.
January 10, 2006	Deadline for Québec employees to provide their employer with their 2005 automobile logbook.
January 30, 2006	Final day for paying any interest on employee loans for 2005 in order to avoid the taxable benefit.
February 28, 2006	Deadline for filing 2005 remuneration slips to employees (T4/Relevé1) and independent sales representatives (T4A/Relevé1), slips for payments of dividends and interest (T5/Relevé3); and the related summaries.
March 1, 2006	Deadline for 2005 contributions to an RRSP
March 15, 2006	First personal income tax instalments for 2006 are due.
March 15, 2006	Commission de la Santé et de la Sécurité du travail du Québec (CSST) filing due date.
March 31, 2006	Deadline for filing trust income tax returns for trusts with a December 31, 2005 year end.

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Additional copies may be obtained by contacting our offices.

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