2009 Tax Changes

Need a little tax tutorial before plunging into another RRSP season? Bring yourself up to speed on this year's tax changes with this succinct overview.

PERSONAL TAX CHANGES

Basic personal/spousal/partner amount

The basic personal amount is the amount of income an individual can earn before paying any federal tax. The 2009 federal budget increased this amount, which is also used for the spousal and partner amounts, by 7.5% to $10,320 in 2009 from $9,600 in 2008.

Personal tax brackets

The upper limits of both the first and second tax brackets were increased by 7.5%. The table below shows the new 2009 versus 2008 tax brackets:

2009	2008	Rate
Less than $40,726	Less than $37,885	15%
$40,726 to $81,452	$37,885 to $75,769	22%
$81,452 to $126,264	$75,769 to $123,184	26%
Over $126,264	Over $123,184	29%

Age credit

The non-refundable age credit is available to Canadians who are 65 years or older and is calculated by multiplying the age amount by 15%. The credit is income-tested and starts getting phased out when net income exceeds $32,312.

For 2009, the amount on which the age credit is based was increased by $1,000 to $6,408. The phase-out, calculated at a 15% rate, means that the age credit is fully phased out when net income reaches $75,032.

CPP changes

In May 2009, the government announced several changes, including the removal of the "work cessation test" and a change in the calculation of benefits if CPP is taken early or late.

The work cessation test currently requires individuals wishing to take their CPP benefit early to stop working for at least two months. The government announced that, beginning in 2012, the work cessation test would be removed, allowing Canadians to begin collecting CPP as early as age 60 without having to quit work.

The other big change affects the calculation of benefits when CPP is taken early (before age 65) or late (up to age 70). There has always been an actuarial adjustment to the basic amount you are entitled to receive at age 65, should you choose to collect CPP early or late.

In the case of someone taking early CPP, this adjustment is meant to reflect the fact that contributions to CPP have been made for fewer years and CPP benefits would be received over a longer period of time. The opposite holds true if you take CPP late.

The adjustments, which have been in place since 1987, are being changed to restore them to their "actuarially fair levels." The early pension reduction will amount to 0.6% per month for each month CPP is taken early and an extra 0.7% per month for each month CPP is taken late. Both adjustments will be phased in gradually starting in 2012 and 2011, respectively.

Home Renovation Tax Credit

Perhaps more attention has been given to the temporary Home Renovation Tax Credit (HRTC) than to any other tax measure in 2009.

The HRTC is a 15% non-refundable tax credit for eligible renovation expenditures made to your home or vacation property. The credit applies to any amount spent over $1,000, up to a maximum of $10,000, producing a maximum credit of $1,350.

In the nine months or so since the credit was introduced, the Canada Revenue Agency has released numerous technical interpretations of exactly which types of renovation expenses qualify for the HRTC. Here's a quick summary of some of the more recent qualifying expenditures:

- Air conditioners and heat pumps that are permanently installed
- Common areas of condos that are paid for either from the condo's reserve fund or a special fund
- Docks: The materials and installation costs for a dock are eligible provided the dock is attached to land that forms part of the eligible dwelling
- Driveways
- Sanding and refinishing of hardwood floors
- Permanently wired or installed home security systems qualify, but ongoing alarm monitoring costs do not
- Landscaping
- Saunas: The costs of installing a wood-fired, 10 x 10-foot, outdoor sauna building on the land that forms part of an eligible dwelling qualifies
- Solar panels on your home or on adjacent land qualify unless the cost is part of the purchase price of the home. You can still claim the full HRTC on the costs of the installation if you've received another government tax credit or grant for installing the solar panels
- Tree removal if the removal relates to a renovation project that is of an "enduring nature and integral to the home"

First-Time Home Buyers' Tax Credit

There is a new non-refundable tax credit based on a $5,000 amount for "first-time home buyers" who acquire a home after January 27, 2009.

Any unused First-Time Home Buyers' Tax Credit can be claimed by the individual's spouse or partner. Note, however, that even if each spouse or partner uses his or her own funds to jointly purchase a new home, the First-Time Home Buyers' Tax Credit is still limited to one credit on $5,000 (as opposed to $5,000 for each spouse or partner).

Home Buyers' Plan

The federal Home Buyers' Plan (HBP) now allows a first-time home buyer to withdraw up to $25,000 (up from $20,000 in 2008) from his or her RRSP to purchase or construct a new home without having to pay tax on that withdrawal.

RRSP/RRIF losses after death

One of the most important tax changes announced in 2009 concerns the tax treatment of an RRSP or RRIF upon death.

When the annuitant of an RRSP or RRIF dies, unless the funds are transferred to a surviving spouse or partner's RRSP (or, under special circumstances, to a dependent child or grandchild), the fair market value (FMV) of the deceased's RRSP or RRIF immediately before death must be included in his or her final tax return for the year of death.

But what if the value of an RRSP or RRIF included on the deceased annuitant's final tax return declines in value after death, but before it's paid out to a surviving beneficiary?

This year's change addresses the issue by allowing the amount of the "post-death" decrease in value of the RRSP or RRIF to be carried back and deducted against the RRSP/RRIF income on the deceased's terminal tax return.

The amount that can be carried back is simply the difference between the amount included as income for the deceased annuitant and the amount paid out of the RRSP or RRIF after death.

SMALL BUSINESS TAX CHANGES

Small business limit

The small business deduction allows private corporations to pay a low rate of federal tax (11%) on the first $500,000 of annual active (non-investment) business income. This is up from $400,000 in 2008.

Computers: Accelerated tax depreciation

To encourage businesses to invest in computer systems and related peripherals, the income tax regulations were amended on May 13, 2009, to add new Class 52 to Schedule II with a 100% tax depreciation rate for eligible computers and software acquired after January 27, 2009, and before February 2011.

This write-off rate is not subject to the traditional "half-year rule," which generally restricts the amount of tax depreciation that can be claimed to half the normal amount in the year of purchase.

TAX PLANNING

Making your interest tax deductible (Lipson)

In what will likely take the prize for the most important tax decision of 2009, the January 4-3 split decision of the Supreme Court of Canada in *Lipson* had a Toronto couple up against the CRA in a case that involved abusive tax planning that breeched the General Anti-Avoidance Rule (GAAR).

The Lipsons lost the case, as the SCC found that they misused the attribution rules. While the Lipson plan itself may be dead, the bigger question is whether the decision will have any impact on a plain-vanilla debt-swap strategy often known as the "Singleton Shuffle."

The Lipsons essentially used a variation on the classic "Singleton Shuffle," named after Vancouver lawyer John Singleton's 2001 Supreme Court victory, which upheld the notion that you can rearrange your financial affairs in a tax-efficient manner so as to make your interest on investment loans tax-deductible.

This technique has been employed by many Canadians who own non-registered investments and are advised to liquidate these investments and use the proceeds to pay off their mortgage. The investors then obtain a loan secured by the newly replenished equity in their home, and use the loan for earning investment income, thus making the interest on the loan fully tax-deductible.

Based on the *Lipson* ruling, it appears that this strategy is still valid and would not invoke the GAAR. As the majority wrote, the CRA "has not established that in view of their purpose (the interest deductibility), provisions have been misused and abused. Mrs. Lipson financed the purchase of income-producing property with debt, whereas Mr. Lipson financed the purchase of the residence with equity. To this point, the transactions were unimpeachable. They became problematic when the parties took further steps in their series of transactions."

For a complete analysis of *Lipson*, see Advisor.ca.

Prescribed rate loans at 1%

Since April 1, 2009, the government's prescribed interest rate has held at the all-time low of 1%, providing couples with a significant income-splitting opportunity.

Income splitting is the practice of transferring income from a higher-income spouse to a lower-income spouse to reduce the overall tax burden of the family. Having the income taxed in the lower income-earner's hands is a strategy prompted by our system of graduated tax brackets.

Unfortunately, "attribution rules" in the *Tax Act* complicate this strategy by attributing any income or gains earned on money transferred or gifted to a spouse back to the original high-earner spouse.

Fortunately, the Act does provide an exception to this rule if funds are loaned, rather than gifted, at the prescribed government rate, and the interest is paid annually by January 30 of the following year.

So if the loan is made while the prescribed rate is 1%, any investment returns above the 1% rate can be taxed in the hands of the lower-income spouse. Note that even though the prescribed rate varies quarterly, you need only use the rate in effect at the time the loan was originally extended.

Tax-loss selling

For tax-loss selling, to guarantee that a trade is settled in 2009, the trade date must be December 24, 2009, or earlier. This will ensure that the settlement takes place in 2009 and that any losses realized are available to the taxpayer this year. Any trade made after December 24, 2009, will not settle until 2010 and therefore those losses will not be available until next year.

Payments required by year-end

December 31 is the final payment date to claim a 2009 tax deduction/credit for various items, including:

- alimony payments;
- charitable donations;
- child care expenses;
- interest expense on money borrowed to earn investment income; and
- investment counseling fees.

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