
YEAR END CONSIDERATIONS DECEMBER 31, 2006

As we draw to a close of the year 2006, year end tax planning should be given top priority as it relates to your personal and corporate affairs. In this regard, we would suggest the following matters be considered.

1. RRSP

Contribute to your RRSP's as soon as possible as the more you increase your capital to finance your retirement, the greater the cash flow will be. For 2006, you can claim an RRSP contribution of up to 18% of income earned from employment or business in 2005, up to a maximum of \$18,000. You are allowed to make an excess contribution of as much as \$2,000 without it being subject to the 1% per month special tax. If you contribute less than the maximum allowable amount of your RRSP in a previous year, you can use your unused RRSP contribution room for 2006 by contributing an additional amount equal to the amount of the unused room. Again, don't wait too long to make up unused room or you will end up with a smaller accumulation of capital in your RRSP when you retire and when you really need the additional cash flow. The contribution must be made by March 1, 2007.

2. RRIF

If you turn 69 in 2006, you must terminate your RRSP no later than December 31 of that year. Do not wait until the last minute to plan for your RRSP maturing. If you do not make appropriate decisions by December 31, the full market value of your RRSP will be added to your taxable

income in 2006. There are many options available including, but not limiting to, transferring your RRSP to a Registered Retirement Income Fund or (RRIF), receiving an annuity, receiving a lump sum, or choosing a combination of these options. You must act now to make the appropriate choice. If your spouse is younger than you, consider creating a spousal RRSP so that you can contribute to the spousal plan until your spouse turns 69, provided of course, that you have unused contribution room. Don't forget that any assets or funds transferred to this spousal plan become the property of the spouse.

3. Borrowed Funds

Interest paid on funds borrowed to make an RRSP contribution is not deductible so therefore you must consider the advantages of whether or not to borrow funds. If you do borrow, make sure that the earnings in your RRSP are growing at a higher rate than your interest payment.

Two recent income tax cases (Singleton, Ludco) may now allow you to use your equity in investment assets to purchase a personal use asset, then borrow funds to repurchase/re-invest in the investment asset and deduct the interest expense. Consult with your tax professionals first before undertaking such a transaction.

4. The \$500,000 Capital Gains Exemption

Shares in a qualified small business corporation and qualified farm property (including shares of a corporation or partnership interest) still qualify for the lifetime capital gains exemption. However, if you have already claimed the \$100,000 personal capital gains exemption, which was abolished in 1994, you are now only entitled to an exemption to a maximum of \$400,000. If you plan to use this exemption in the current year or subsequently and if you have an outstanding cumulative net investment loss (more popularly referred to as CNIL) as at December 31, 2006, you cannot claim the full exemption before using up the CNIL amounts, that is, you must reduce the CNIL to zero. If you are a shareholder of a private corporation, the quickest way to reduce your CNIL is to increase your investment income, and particularly, the interest or dividend income you receive from the corporation. However, you should consult your tax professional before adopting any of these strategies as ABIL deductions in item #6 will affect the use of the capital gains exemption as well.

5. Capital Losses

If you suffered capital losses in the current year, you can use these losses to reduce your taxes for the current year. Of course, now you are going to ask, How? By using the current year's capital loss against any capital gains realized in the current year, you can net out as to the amount that will be ultimately taxable. Be Careful! Superficial loss rules prevent the taxpayer from claiming a capital loss on an asset that the taxpayer clearly intended to continue to hold. Therefore, if you purchase an identical asset within 30 days of selling the first asset, these rules will apply. Complicated? - You betcha! Again, consult your tax professional before arbitrarily realizing your capital losses. Be cognizant of non-arms length sales and/or sales to affiliated persons.

If you had capital gains in a prior year and capital losses in the current year, you may be able to carry back these losses against prior years' gains and recover taxes paid in said prior year. Consult with your tax professional before proceeding with any loss selling.

6. How to Offset Taxable Income With an Allowable Business Investment Loss (ABIL)

If you are fortunate enough to have an ABIL, you will be able to reduce your overall taxable income. An ABIL is a loss on shares and/or debt you own of a small business corporation. In fact, although capital losses can only be used to reduce capital gains, an ABIL can be used to reduce your overall income. However, the paperwork, the documentation, the overall financial details must be in place prior to claiming this ABIL on your tax return. Proper preparation and details as to planning will go a long way in allowing you to have this ABIL claimed properly on your tax return and accepted.

7. Investment Deadline

When making your investment decisions for year end purposes, remember that security transactions are often finalized on the settlement date, that is, 3 business days after the trade date. The last date allowed for trading securities in 2006 is December 22. If the transaction is a cash sale (payment made and security documents delivered on the trade date) you have until December 31, 2006.

8. Defer Your Income

Good year end tax planning often includes, among other measures, deferring some income to the next year. Therefore, it may be advantageous to shift taxable income to the year 2007 as tax rates for individuals begin to decrease. This planning must be measured when one considers if their income for next year will be substantially higher or substantially less. Each case is different and your tax professional can be very helpful for budgeting these decisions.

9. Donations

If you have not already done so, now is the time to reconsider your donations program for 2006 and benefit from the charitable donations tax credits. The Federal Credit is equal to 16% of the first \$200, and 29% for any donation in excess of \$200. Have you even considered donating shares of public companies? Donations of these shares after May 1, 2006 are subject to no capital gains tax.

If you are thinking about making a charitable gift before the end of the year, and exercising stock options acquired during the same period, then transferring the shares acquired under employee stock options to a charity can also be an effective tax-saving strategy. Donating the shares to a qualifying charity would effectively reduce the **employment** benefit to nil. This easing measure only applies in respect of shares acquired that were donated in the year and in the 30 days after the option was exercised. Under such circumstances, it seems preferable to exercise the option and donate the shares, rather than to sell them once the options are exercised and donate the proceeds.

The government has recently introduced rules to curtail the use of certain aggressive charitable gifting strategies. If these rules are enacted as proposed, all donations-in-kind could be caught - not just those made as part of a charitable gifting arrangement. If you have donated property other than cash to a charity, you should contact your tax professional to determine if you are impacted by these rules.

10. Tax Advantage of Tax Shelters

Beware - beware - beware! Tax shelters are a known means of reducing income taxes. However, many Canadians have discovered, the hard way, that the most important aspect of a tax shelter is the quality of the product and not the immediate tax savings that may be had. Therefore, before making any decisions, no matter how simplistic they would appear on the surface, and no matter how enticing, we strongly recommend and urge you to consult your tax professional before doing anything as it relates to tax shelters.

11. Shareholder Loans

If you have borrowed money from your corporation, you must repay the loan before the following fiscal year end so as to avoid being taxable in your hand as a shareholder benefit. If you delay, the full amount of the loan will be added to your income for the previous year. The exception is if the loan is made to an employee shareholder for purchasing a residence, securities issued by the employer or a car for work

purposes. Interest on shareholders' loans are considered a taxable benefit.

Alternatively, there may be situations where you have loaned an amount to your company. Although such loans are often non-interest bearing, it might be beneficial to charge your company interest. If you have borrowed an amount from, or loaned an amount to your corporation, you should contact your tax professional to review the tax consequences.

12. Bonus

For December 31, 2006 year ends, a small business tax deduction is available to Canadian controlled private corporations with federal active incomes of less than \$300,000 (increased to \$400,000 in 2007). If the annual business income of your company exceeds \$300,000, the company could pay out a bonus to bring its income below \$300,000. If the company's fiscal year is not a calendar year, the amount must be determined on a pro rata basis from the number of days in the fiscal year that fall within each of the calendar years. However, you must be aware of the fact that this bonus must be paid within 180 days of the corporation's fiscal year end as well as the income taxes thereto applicable within the appropriate time period after the 179 day period.

13. Taxation of Dividends (NEW)

Starting in 2006, the Federal Government has introduced a new tax rate for "eligible" dividends paid by public and private companies. Prior to 2006 the top tax rate on all dividends received from Canadian companies was 31.34%. For 2006 "eligible" dividends will have an approximate tax rate of 25.09% while "ineligible" dividends are still taxed at 31.34%. Contact your tax professional as to how the new dividend tax systems affects both your personal and corporate taxes.

14. RRSP's - Children

Another example of often overlooked opportunity involves advising clients and their children about setting up an RRSP, even before the deduction becomes useful. This can build strong savings habits, long term investment growth and a big fat deduction when children finally start paying taxes.

A single RRSP contribution of \$400 at age 10 compounding at an average return of 9%, will grow to almost \$46,000 by the time the child is 65. Therefore, if the child makes \$400 contribution every year until he turns 19, he will have more than \$300,000 in his RRSP. You may suggest that once the child turns 19, the child can add the over-contribution amount of \$2,000 to the RRSP and the RRSP will grow to more than \$425,000 by the time that child turns 65. Amazing!

15. Contribute to RESP

Registered Education Savings Plans are becoming more attractive since 1998. The government grant is equal to 20% of the contribution to the child's RESP (to an annual maximum of \$400). The maximum annual grant is increased to \$500 for families with incomes of \$36,378 or less, and to \$450 for families with incomes between \$36,378 and \$72,756. These grants accumulate in the RESP along with contributions to the plan until the child goes to college or university. If you fail to make an RESP contribution in a year, or if your contribution yields a grant of less than the maximum, the unused CESG room is carried forward, but your ability to utilize CESG room in the future is limited. Therefore, if you are considering making an RESP contribution, it is beneficial to make it before the end of the year to ensure that the CESG is maximized (Canada Education Savings Grant or CESG).

16. Summary - RRSP Season

- a) Don't wait until the rush of the RRSP season before contacting your professional.
- b) Meeting with your professional to review your current situation to see that you have been maximizing your contributions.
- c) Obtain copies of your RRSP summary information, ie: the annual notice of assessment or reassessments from the Canada Customs and Revenue Agency, and make sure that it reconciles with the T-1 returns properly filed.
- d) With a little bit of creativity, you should be able to increase the amount of your annual RRSP contributions from a family perspective.

17. Medical Expenses

In general, medical expenses in excess of the lesser of \$1,844 and 3% of your net income that are paid in any 12-month period ending in 2006 are eligible for a non-refundable federal tax credit. Therefore, proper timing of the payment of major medical expenses could increase your available tax credit. Also, remember that premiums paid to private health and dental service plans, including those taken out for foreign travel, are considered medical expenses for purposes of the credit. These amounts can be significant and should not be overlooked.

The net income limitation noted above applies to medical expenses you claim for you, your spouse or common-law partner and minor children. However, if you pay medical expenses for a dependant other than your spouse or common-law partner and minor children, the ability to claim a medical expense credit is based on the dependant's net income, not your own. As a result, even limited payments can qualify where the dependant's income is quite low. Don't forget to claim these amounts when you file your tax return.

18. Disability Tax Credit

Rules have recently been introduced to enhance the types of impairments that qualify for this credit. For example, it has been extended to individuals with multiple restrictions, where the cumulative effect is to result in a marked restriction in a basis activity of daily living. Many children with Type 1 diabetes should now also qualify for this credit. If you have not claimed this credit in the past, but you think you might qualify, Form T2201 must be completed by a qualified medical practitioner and filed with your tax return for the year.

19. Adoption Expenses

Effective for 2005 and subsequent years, there is a new non-refundable tax credit for certain expenses incurred to adopt a child. This credit is subject to a maximum claim of \$10,000 (indexed for taxation years after 2005).

Eligible expenses include court, legal and administrative expenses, reasonable travel and living expenses, fees paid to a licenced adoption agency, mandatory fees paid to a foreign institution and document translation fees.

The credit can be claimed in the year the adoption is finalized and includes all eligible expenses incurred during the adoption period.

20. Tuition and Education Credits.

If your kids are at school, then they may qualify for **Education and Tuition Credits**. But the beauty of this is that if your kids do not have any income to use up these credits, they can be transferred to you.

A student may deduct from federal taxes payable an Education Credit of 15.25% of \$465 per month (\$71 a month) for each month in the year that the student is enrolled as a full-time student at qualifying programs. (Note: There is no full-time enrolment requirement for students who are disabled.) Part-time students are entitled to claim a federal education credit of 15.25% of \$140 a month (\$21.35 per month).

In addition to the Education Credit, students may also be eligible for a credit for tuition fees paid where fees are in excess of \$100 (for post-secondary level or paid to an institution certified by the Minister of Human Resources). The credit is equal to 15.25% of the tuition paid for the year.

These education and tuition credits may be transferred to a spouse, parent, or grandparent, subject, of course, to certain limits; the lesser of the total amount of tuition and education credits combined and \$5,000, less the amount claimed by the student. Any unused education and tuition credits can be carried forward for future use by the student.

21. Have Your Kids Report Capital Gains. If an investment is owned by your kids, the gain can be reported on their tax return. This could dramatically slash - even eliminate - the tax bite. How so? With the basic personal credits guaranteed to each taxpayer under our tax laws, a child or grandchild with no other income can

make up to \$17,500 a year (with the new 50% capital gains rate) in capital gains per child tax free! And even if the gain exceeds this amount, so that your child is in the lowest tax bracket, the tax rate is only about half what a high-income earner would pay. (Note: in most cases, the funding parent must normally pay tax on interest and dividends generated by the investment until the year the child turns 18).

22. Scholarships (NEW)

All scholarships, fellowships and bursaries received in connection with the enrolment in a program eligible for the education credit will be exempt from taxation. Currently the exemption is \$3,000.

23. Textbook Tax Credit (NEW)

Students will be eligible for a new tax credit to recognize the cost of textbooks. Full-time students - \$65/month, part-time students - \$20/month. The amounts will be added to tuition and education amounts for purposes of transfers to supporting individuals and carryforward provisions. Effectively, this is an increase in the education credit.

24. Public Transit Tax Credit (NEW)

A non-refundable federal credit for transit passes for buses, trams, subways, trains, and ferries will be eligible but must be for a duration of at least 28 days, must be reasonable to expect the individual will return daily to the place of departure. You can claim transit passes for individuals, spouse/partner and children who are under age 19 at the end of the year. This is effective for the cost of transit passes used after July 1, 2006.

25. Fairness Rules and Refund Requests

The fairness rules allow individuals and testamentary trusts to request a refund for prior taxation years. However, such adjustments are limited to the ten prior years. If you think you may be entitled to a refund for the 1996 taxation year, you should make sure that the request is made before January 1, 2007.

26. Canada Employment Credit (NEW)

Non-refundable credit to help alleviate the fact that certain employment related expenses cannot be claimed. For 2006, it is based on the lesser of employment income and \$250. For subsequent years, it will be based on the lesser of employment income and \$1,000 (subject to indexing). Employees who deduct commission expenses will also be entitled to this credit.

27. Estate Planning

Is your Will up-to-date? What taxes is your estate facing upon your demise? An excellent New Year's Resolution would be getting your estate planning in order. Consult with your professional advisors.

28. File Returns For Your Kids. Even if a return is not required, kids with employment income should still file. Salary income builds their RRSP contribution room. So by filing returns when kids are young, a catch-up contribution can be made later, based on 18% of the accumulated salaries. Also, tuition and education credits not required to nil-out tax can be carried forward for use in future years.

29. Claim Interest on "Disappearing Investments". If you've borrowed for an investment or business that has been sold at a loss or gone belly-up, but you are still stuck with making interest payments, the interest may continue to be deductible. (In the event you have managed to salvage some proceeds and the money is put to personal use rather than re-invested, a portion of your continuing interest charges won't be deductible).

30. Foreign Taxes

Double taxation by another country is a frequent cause of unnecessary and unexpected tax bills. If you do business or invest in other countries, or are a citizen of a country other than Canada, get expert advice from a professional who understands the tax laws of both countries.

If you have received investment income from a foreign source, don't forget to claim a foreign tax credit on your return. As a result of certain tax rules, your federal foreign tax credit may be restricted. If so, it's possible to claim a foreign tax credit against provincial income taxes, and any excess foreign tax credit may be deductible. If you paid US taxes, then file a US return for a refund of all or part of the US taxes paid.

If you hold US investments through your RRSP, the Canada-US Treaty now allows your carrier to apply for a refund of US withholding tax.

31. Reserves

If you sold an investment for a capital gain, but you're not entitled to receive cash proceeds until after the end of the year, you're allowed to defer a portion of your capital gain by claiming a reserve. Reserves on capital gains may enable you to defer your tax over a five-year period. Consult with your tax professional to take complete advantage of this option.

32. Objection Expenses

You can deduct legal fees paid for advice to object to or appeal an assessment under the Income Tax Act, the Unemployment Insurance Act, the Canada pension Plan or the Quebec Pension Plan, plus any related accounting fees (net of any award or reimbursements for such expenses).

33. Which Province Taxes Your Income?

Employment and investment income are taxed by the province in which you reside on December 31st. This holds true even if the income was earned in another province. On the other hand, business income is taxed in the province where the business was conducted, provided you have a permanent establishment in that province.

If you are moving or transferring to a province with a lower tax rate, you should consider accelerating your departure to arrive before the end of year deadline. Conversely, if a move to a province with a higher tax rate is in your future, postpone your relocation until after the year end, if at all possible.

34. Get Your GST Back. If you have employment expenses or you are a partner in a business deducting expenses that were not claimed by the partnership, you can claim a rebate to recover the GST included in the price of goods and services for which you have claimed a deduction. You must report your GST rebate as income in the following year.

35. When to Consider Incorporating. Here are four key guidelines as to when you should seriously consider incorporating a business:

→ **Healthy Profits** - This means that your annual taxable income, including from your business, should be well in excess of the \$35,000 threshold where the lowest tax bracket ends.

→ **No Losses Expected** - If you incorporate your business, tax losses are deductible only to the corporation - not you. So don't incorporate until you have achieved profitability.

→ **Low-Bracket Family Members** - By putting family members on the payroll, salaries you pay them can be deductible from your business income as long as they are not unreasonably large, given the services performed.

→ **Use of Your Company's Profits** - You can leave at least some of your business profits in the company or you may be able to make tax-effective use of low-income family members as shareholders.

→ **Professionals** - Such as doctors and lawyers, can now incorporate.

The Bottom Line - Dramatic reductions in corporate tax rates are now kicking in - so dramatic that they will reshape tax planning, making incorporation an even more lucrative strategy than it was before. When you combine the Small Business Deduction with the lower rates, you can save a bundle. This is provided that either you leave at least some of your profits in your company for reinvestment, or if you do need your company's profits to live on, that you have a spouse, parent, or adult child in a low tax bracket. Consult with your tax professionals when contemplating such a move.

36. Looming Tax Deadlines

| | | |
|---------|--|---|
| Dec. 15 | Final quarterly instalment of tax due | For individuals (other than unincorporated farmers and fishermen) |
| Dec. 31 | Final payment dates for a 2006 tax deduction or credit | <ul style="list-style-type: none"> • Alimony and Maintenance payments • Charitable donations • Child care expenses • Contributions to your own RRSP if you are 69 by December 31 • Investment counsel fees and other investment expenses • Medical expenses • Moving expenses (of individuals) • Political contributions • Safety deposit box rental fees (not deductible in Quebec) • Tuition fees |
| Jan. 15 | Stock option benefits U. S. Taxes | <ul style="list-style-type: none"> • Last day for employees to file or revoke designations to defer stock option benefits on options exercised in 2006 • Estimated tax payments for individuals |

37 . Top Marginal Tax Rates - 2006 and 2007

The following charts provide a summary of key Ontario top personal (2006) and corporate tax rates for 2006 and 2007. These rates should be carefully considered when mapping out tax planning strategies with your advisors, but remember that tax rates are always subject to change.

**Personal Tax Rates (%)
Federal & Ontario Combined Top
Marginal Tax Rates**

| 2006 | | | |
|----------------------------|---------------|-------------------------------|-----------------------------|
| Interest & Ordinary Income | Capital Gains | Ineligible Canadian Dividends | Eligible Canadian Dividends |
| 46.41 | 23.21 | 31.34 | 25.09 |

| 2006 Ontario Corporate Tax Rates (%) | | | | |
|--------------------------------------|------------------------|------------------------|-------------------|-------------|
| | Active Business Income | | Investment Income | |
| | Up to \$300,000 | \$300,000 to \$400,000 | Over \$400,000 | All Amounts |
| M&P | 18.62 | 27.62 | 34.12 | 49.79 |
| Non M&P | 18.62 | 27.62 | 36.12 | |

| 2007 Ontario Corporate Tax Rates (%) | | | |
|--------------------------------------|------------------------|----------------|-------------------|
| | Active Business Income | | Investment Income |
| | Up to \$400,000 | Over \$400,000 | All Amounts |
| M&P | 18.62 | 34.12 | 49.79 |
| Non M&P | 18.62 | 36.12 | |

All of the above should be done in conjunction with your tax professional, so that you can maximize the benefits of year end planning. These suggestions are not all inclusive and are a guide only. They are not intended to be a substitute for competent professional advice. No action should be initiated without consulting with your tax professionals.

Yours very truly,
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