Tax Tidbits – October 2015

Tax deferral by RRIF

A registered retirement income fund ("RRIF") is a tax deferral vehicle similar to the registered retirement savings plan ("RRSP"). Both allow income to accumulate tax free and both require distributions to be taxed in the hands of the recipient.

While one can open a RRIF whenever they choose, an RRSP must be cashed out or converted to another retirement income vehicle (such as a RRIF) by December 31 in the year one turns 71 years old.

Unlike RRSP's, minimum annual withdrawals are required to be taken from a RRIF. The minimum amount is calculated at a prescribed percentage of the opening value of the fund each year.

Previously, the minimum withdrawal was 7.38% of the value at the beginning of the year at age 71. This minimum increases annually based on a schedule contained in the Income Tax Act *(Canada)* ("ITA") and tops out at 20% for taxpayers 94 years or older.

In light of historically low interest rates on investments and longer lifespans of taxpayers, the minimum withdrawal amounts have been reduced for 2015 and later taxation years. For example, at age 71 the minimum withdrawal has been reduced from 7.38% to 5.28%, the result being less tax and more deferral.

Since the reduced rate was introduced in the 2015 Federal Budget in April 2015, many taxpayers may have already withdrawn 7.38% of the value of their fund, adding taxes unnecessarily on the additional withdrawals in 2015.

A re-contribution of the excess 2.1% is permitted providing it is made prior to March 1, 2016. This re-contribution will be deducted on the taxpayer's 2015 tax return, similar to the treatment of RRSP contributions.

Where the re-contribution is made between January 2, 2016 and March 1, 2016, it will not increase the opening fair market value of the fund on January 1, 2016 on which the 2016 minimum withdrawal is calculated. This will effectively reduce the minimum withdrawal for 2016 as well as minimize the taxes on the 2015 withdrawal.

Please contact **Dario Bon** of the **Manning Elliott Tax Team** with any questions.

Improving housing affordability could increase tax costs

The popularity of detached secondary dwellings has continued to grow throughout the Lower Mainland ever since the City of Vancouver approved them in 2009 to promote affordable housing. While referred to as "laneway homes" in this article, these dwellings are also known as "coach houses", "garden suites", "garden cottages", "carriage houses" or "granny flats" depending on their location.

Laneway homes are typically rented out to supplement the cost of living in the Lower Mainland, but are also used to keep aging parents or disabled adult children independent yet close, or to assist adult children who cannot afford to purchase their own home.

The income tax implications of building and renting these homes may surprise homeowners, particularly with respect to the principal residence exemption ("PRE").

The PRE can be used by Canadian-resident individuals to shelter their gain on the sale of a principal residence. However, the exemption is only available to a family for <u>one housing unit</u> in any year and the home must be "ordinarily inhabited" by the owner or certain family members (generally, spouse and children).

Despite both homes being on the same title and on the same land which cannot be subdivided, the introduction of a self-contained laneway home with its own entrance and separate electrical, plumbing and heating systems brings into question the ownership of <u>more than one</u> housing unit for tax purposes. "Housing unit" for PRE purposes is not defined in the ITA. However, based on its ordinary meaning and the Canada Revenue Agency's ("CRA") administrative position, a laneway home would be considered a separate housing unit. In contrast, a suite within the main home is considered by the CRA to retain its nature as a principal residence where the income-producing use is <u>ancillary</u> to the main use of the property, there is no structural change and no capital cost allowance (tax-equivalent of amortization) has been claimed.

After construction is completed and the laneway home is rented to arm's length parties, it would no longer meet the "ordinarily inhabited" rule for the PRE. It would also trigger the "change of use" rules and cause a deemed disposition for tax purposes – of the laneway home and the land that "contributes to the use and enjoyment of the housing unit as a residence". Any portion of the gain that is not sheltered by the PRE will be taxable – this could be significant depending on the number of years that cannot be designated for the PRE and the growth in value of the property since acquisition.

Furthermore, the PRE designation relates to the entire property. Upon subsequent sale of the property, the years designated upon the change in use of the laneway home are no longer available to be claimed – this could also trigger a significant gain on the eventual sale despite the “bump” in the cost of the portion of the property used for the laneway home.

Homeowners should keep all records associated with the expenses of building the laneway home in order to substantiate the tax cost of the property. When making the PRE designation, taxpayers should also consider the impact on the future sale of other properties that qualify for the PRE during the same years, for example any vacation homes.

While the lure of additional rental income may be appealing, professional tax advice should be sought when contemplating adding to your property. Also, stay tuned for a future Tax Tidbits article addressing the commodity tax implications (i.e. GST) of building and renting a laneway home.

Please contact **Wendy Seet** of the **Manning Elliott Tax Team** with any questions.

And More…

- **It pays to lose the Federal Election**

  Individual tax rates in Canada are based on the province of residence on December 31st. Stephen Harper stands to save taxes of about $18,000 by moving from Ontario to Alberta before the end of 2015 due to the lower tax rates in the Prairie province.

- **Back To The Future**

  “Back To The Future Day” was celebrated in October by many movie fans that fondly remember when Marty McFly used Doc’s Delorean time machine to travel from 1985 to the distant future of October 21, 2015. A recent Forbes article[1] noted the differences and similarities of the US tax system in 1985 and 2015 and pointed out that hot topics during both times included simplifying the Tax Code, lowering tax rates, and a call for bipartisan cooperation. Some things never change!

- **David Copperfield’s Canadian tax returns magically disappear**

  The CRA has demanded that the famous magician pay US$471,000 in back taxes and penalties for failing to file his Canadian tax returns to report the income earned while touring Canada in 2008 and 2009. The man that made the entire Statue of Liberty vanish into thin air has been unable to do the same to his Canadian tax liability.

[1] http://www.forbes.com/sites/kellyphillipserb/2015/10/21/back-to-the-future-taxes-now-then/