PERSONAL **Newsletter**

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Tax Planning for Year End

With 2023 coming to an end, it's the perfect moment to consider what tax planning strategies may be available to you. Year-end tax planning usually involves the deferral of tax by either accelerating tax deductions or deferring income until after the end of the taxation year. This article will discuss, very generally, some of the common year-end tax planning strategies that may be to your advantage. Remember to always seek professional advice if you wish to explore any of these opportunities.

Expenses To Pay Before Year End

You should consider paying the following expenses by December 31:

- Investment counsel fees;
- Union dues and professional fees;
- Child care and support payments;
- Charitable donations;
- Moving expenses;
- Fees and expenses incurred in objecting to or appealing an assessment of taxes, penalties, or interest with respect to income taxes, CPP, or EI;
- Expenditures that qualify as medical expenses for the purposes of the medical expense tax credit;
- Repayment of an insurance policy loan where that policy loan has been included in income as the proceeds of disposition of a life insurance policy. The deduction in respect of a repayment is limited to the amount by which the total income inclusion exceeds amounts deductible in previous years in respect of repayments;
- Legal expenses incurred in collecting salary or wages from an employer or former employer;
- Tuition fees paid in respect of the taxation year;
- Interest charges.

Family Trusts

If you have a family trust and would like to ensure that the beneficiaries are taxed on the income, in most cases it is necessary that the income be either paid or payable by the end of the calendar year. If actual payments are not made, then promissory notes or other evidence that there is a legal obligation to pay should be in place. There is also a "preferred beneficiary election" that allows a trust to allocate taxable income to a beneficiary with a disability without the trust actually paying the income to that beneficiary.

Year Ends of Mutual Funds and ETFs

Mutual fund trusts can have their year end as December 15. While the main reason for this relates to internal bookkeeping matters, this early year end can affect year-end tax planning strategies. Note that exchange-traded funds ("ETFs") are subject to the same tax rules as mutual funds.

Mutual funds allocate their capital gains and other income just prior to year end so that unit holders (other than RRSPs or other exempt holders) pay tax on the distributions. But "buying in" just before the distribution date usually carries a hidden tax penalty. Basically, tax will be paid on someone else's gain (the gains prior to the year-end distribution date are already factored into the cost of the fund, so part of one's purchase price effectively becomes taxable). Thus, consider deferring a large purchase into a new fund or ETF until the new year.

If the fund moves its year end forward to December 18, for example, an individual will escape this tax trap if they buy after this date — even if one has bought in the current calendar year.

Another advantage of the early year end that has been cited is that, if the mutual fund makes capital gains distributions, the accelerated year end will give an individual time to trigger tax losses by the end of the year. Strategies involve selling losing stocks, or switching a losing fund to another fund, e.g., within the same mutual fund "family". A better strategy may involve transferring ownership to children. This allows a taxpayer to effectively keep the investment in the family and avoids brokerage fees. However, this does not work with a spouse/common-law partner (since the "superficial loss rules" would, in that case, deny the loss where the same or similar property is reacquired within 30 days).

To determine the potential benefit of these strategies, it is helpful to find out exactly how much the capital gains distribution will be. Mutual fund companies often provide estimated tax attributes of their funds' distributions before year end. If one intends to sell off low-value stock (or other investments with accrued losses), one must bear in mind that most stock market sales must take place more than three business days before the end of the year. Not all mutual funds intend to take advantage of the accelerated year end. The exact date may vary from fund to fund.

Lower Tax Instalments

If an individual is an instalment-basis taxpayer whose income has gone down in the last couple of years, the possibility of reducing instalments should be considered.

The CRA's instalment calculations are based partly on an individual's income tax position two years ago and partly on last year's position. Instead of using the CRA's method, an individual is entitled to base their instalments on last year's tax position. An individual can even base their instalments on the current year's estimated tax

position, if lower; however, one should be careful in doing so, as penalties may apply if one underestimates their taxes and the instalments turn out to be lower than the other two options required.

Increase Business Expenses

Deductions for most normal business expenses are based on whether the expense has been incurred by year end, rather than whether the item has actually been paid for (e.g., office supplies, auto and other repairs, etc.,). Exceptions include: compound interest charges — regular ("simple") business interest can be expensed when payable (by normal method); site investigation and utility service connection charges; and disability-related equipment and building modifications.

Consider accelerating purchases of equipment and other capital expenditures before year end. Examples include auto and equipment purchases (half of the normal depreciation can be claimed in the current year and the full depreciation rate in the next year) and so on. This strategy is especially effective currently, as the immediate expensing incentive currently allows a taxpayer to fully deduct up to $1.5 million of capital expenditures that would otherwise be depreciated over time.

Tax Loss Selling

Tax loss selling means the sale of investments which are in loss positions prior to year end in order to obtain a capital loss. In many cases, these losses could result in a valuable tax break.

If there are capital gains in the last three years which were not fully sheltered by the capital gains exemption, it probably makes sense to sell off losing investments before year end. This is because capital losses can be claimed against capital gains as far back as three years, or for the current or a future year.

On the other hand, if an individual did not have to pay tax on capital gains there is likely no reason to take a tax loss before year end. This is because capital losses can only be deducted against capital gains.

Besides selling on the market, another way to "trigger" a capital loss is by giving or selling the investment at current market value to children or parents (unfortunately, this cannot be done with a spouse/common-law partner). It is recommended that the transfer agent should be notified of the change. One should also have a written agreement to document the transfer.

Final RRSP Contribution

Notwithstanding that an RRSP contribution cannot be made after the year in which the annuitant turns 71, if the individual has earned income in the final year in which an RRSP contribution can be made, it may be possible to make the next year's contribution late in the final year, incur a (modest) penalty tax as a result of the temporary over-contribution, and carry-forward the deduction to the next year. An alternative strategy could be to contribute to a spousal RRSP if the individual's spouse/common-law partner is still eligible to make contributions.

Watch Deadlines

Many tax deadlines apply to businesses. In some cases, severe penalties may apply if these are missed. One hidden trap is that if one company has amalgamated with another, there is a deemed year end (normally the day before the amalgamation).

Here are a few deadlines to watch out for:

- **Bonuses.** To be deductible in the current year, bonuses must be paid within 179 days after the company's year end.
- **SR&ED claims.** These must be made within a year of the tax return due date. There is no specific rule which allows late filing.
- **Shareholder loans.** If a shareholder loan was made in the company's previous taxation year, ensure that it is repaid before the end of the company's current taxation year to avoid income inclusion for the full amount of the loan. If the loan cannot be repaid in cash, consider transferring other assets to the company in repayment of the loan, i.e., with a value equivalent to the amount of the loan that is being reduced. The best way to do this is to transfer business assets, e.g., office equipment, computers, and so on. One should bear in mind that capital gains or other tax exposure on these transfers are possibilities.

Defer Tax on Interest

You can defer tax on an interest-bearing investment for one year after its purchase, unless the interest is paid or credited to a taxpayer's account in the meantime. Accordingly, for investments on which interest payments are deferred (e.g., payments that occur once or twice a year), it may make sense to make the purchase early in the new year, rather than late in the current year, since this means that at least a portion of the interest payments will be "kicked over" to the next year.

RESP Contributions

Although there is a $50,000 lifetime RESP contribution limit, there is no annual limit. However, making an RESP contribution before year end makes sense because the annual contribution continues to determine the amount of the annual Canada Education Savings Grant, normally based on 20% of calendar-year contributions, to a maximum of $500 per beneficiary, to a lifetime limit of $7,200. Eligible beneficiaries from families with middle and low income can receive an additional 10% or 20% of the first $500 contributed to the RESP.

Because there are limits on the amount of federal grant available each year, it is important to spread RESP contributions over several years in order to maximize the amount of the federal grant. For instance, contributing $50,000 up front will generate only a $500 grant, and because the limit will have been reached for RESP contributions the remaining potential $7,000 of grant money will be lost.

Source Deductions

An unlikely source of cash could be the source deductions withheld on salary income. Many people regularly get tax refunds because of deductions such as employment expenses, RRSP contributions, support payments, medical expenses, donations, and past service pension buybacks, to name a few. An individual in this position should apply for a reduction of source deductions. A taxpayer can apply for a reduction of source deductions if they have legitimate deductions or tax credits that are not considered when their employer calculates the source deductions.

Pay Interest on Employee Loans

If an employee receives a low-interest or interest-free loan from their employer (or past or future employer), the employee is considered to have received a benefit from employment. The benefit is set at the CRA's current prescribed rate of interest minus any interest

actually paid during the year or within 30 days of the year's end. If such a loan is outstanding, and if the loan proceeds were not used for an income-producing purpose such as making investments, one should bear in mind that interest should be paid on the loan for the current year by January 30th of the next year to reduce or eliminate any taxable benefit.

Employee Auto Benefits

If an employer provides an employee with an automobile and also reimburses any operating costs during the year, an operating cost benefit per kilometre driven for personal use will be included in the employee's taxable income. If the employment-related use is more than 50%, one may be able to use an alternative method of calculating operating cost benefit as one-half of the "standby charge" the taxable benefit of which is, essentially, either 2% of the car's original cost for each month it was available to the employee (i.e., 24% per year) or two-thirds of the lease costs. The alternative benefit calculation will generally be advantageous if the car's original cost is relatively low and the personal kilometres are relatively high (even though they must still be less than 50% of the total use). To use this alternative calculation, the employer must be notified in writing by December 31 that the employee intends to do so.