THE GLOBE AND MAIL

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TAX MATTERS

Your tax planning should be a priority right now

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My grandmother used to hate being late for anything. She would set her clock ahead by 10 minutes with the expectation that this would make her on time. I don't recall this habit actually helping her to be on time – but it did sharpen her subtraction skills. When it comes to being on time, tax planning should be a priority right about now because there's still time to make a difference in your ultimate tax bill for 2020. Today, I want to share ideas that investors can take before year-end to minimize tax in this COVID-19 world.

Investing versus debt reduction. Many people today are wondering whether they should be paying down debt or investing money. Given how low interest rates are today, and are likely to remain low for an extended period given the pandemic, it can make good sense to invest available funds for growth over the long term rather than pay down debt – particularly where the interest on the debt is under about 4 per cent. This is true especially where that interest is tax-deductible. Paying down high interest debt, like credit cards, always makes good sense.

Making your interest deductible. Do you have any debt with non-deductible interest? If so, consider liquidating some of your investments outside of your registered plans (count the tax cost first – which may be low given the direction certain investments have taken this year) and use the proceeds to pay down the debt. Then reborrow, at low rates today, to replace your investments. This can create interest deductibility for 2021 since you'll be borrowing to earn income.

Realize losses before year-end. Selling investments that have declined in value this year can allow you to apply those losses against capital gains this year, or in one of the three prior years (2017, 2018 or 2019). Losses must be applied to the current year first, then can be carried back up to three years or forward indefinitely.

Realize capital gains in some cases. Triggering capital gains before year-end can make sense if it won't result in a tax bill – perhaps because of capital losses to use up, or where the gain will be taxed in the hands of someone with little income, which could be common in 2020. Also, some are concerned about a potential increase in the capital gains inclusion rate to help pay for the pandemic support the government has provided. If you're in this camp, realizing capital gains today at current tax rates could make sense over waiting and paying tax potentially at higher rates later – especially if you're thinking of realizing those gains in the next year or two anyway.

Limiting capital gains reserves. If you sell certain types of assets (real estate comes to mind) and you collect your sales proceeds over time, you may be eligible to claim a capital gains "reserve," which allows you to pay tax over more than one year (as long as five years). If you're concerned that tax rates on capital gains will be rising in the future, it could make sense to pay tax on more of your capital gains today (that is, claim less of a reserve) to take advantage of today's tax rates on capital gains.

Time the purchase of investments. Given how low interest rates are today, some people are investing in longer-term interest-bearing securities to try to improve the yield they're earning. If you're looking to invest in an interest-bearing security that has a maturity of one year or longer, consider waiting until the new year. The reason? You won't have to pay tax on any accrued interest until 2022 – the year of the first anniversary of the investment. Also, consider waiting until early in 2021 to purchase mutual funds that are expected to make taxable distributions before the end of 2020. Otherwise, you'll pay taxes sooner than necessary.

Close out option contracts with losses. If you close out option contracts with accrued capital losses before year-end, you'll be able to utilize those losses to offset realized capital gains this year, or in 2017, 2018 or 2019.

Donate securities to charity. Charities, like certain businesses, have been significantly hurt during COVID-19. Consider donating before year-end if you can. The tax relief can be helpful in offsetting taxes that could be owing on the Canada Emergency Response Benefit (CERB is taxable, and no withholding taxes were deducted when paid) or other income. And you'll do well to donate eligible securities that have appreciated in value since our tax law will eliminate the taxable capital gain on these securities, in addition to providing the tax relief for the donation itself – a double benefit.

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